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Excise Act

Review



A Proposal for a Revised
Framework for the Taxation of
Alcohol and Tobacco Products

February 1997

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Excise Act

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A Proposal for a Revised
Framework for the Taxation of
Alcohol and Tobacco Products

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Part I

Introduction

Preface

This paper presents a comprehensive proposal for a revised federal commodity taxation system in respect of alcohol and tobacco products. The revised system encompasses both a new legislative framework and a modern administrative function for the application of federal excise levies.

The proposal for a revised excise framework is the result of a co-operative effort between the Department of Finance and Revenue Canada, with input from industry associations and provincial liquor jurisdictions. The focus of the revised excise framework is to replace archaic legislation and complex administration with an integrated modern structure that recognizes and accommodates the needs of government and industry.

Background

Historically, commodity taxes on specific goods have been a significant element of the federal tax system, accounting for as much as 25 per cent of federal revenues in the first half of this century. While their relative importance has declined over recent years, these levies continue to represent an important source of revenue to the federal government.

Among the most significant federal excise levies are the charges imposed on alcohol and tobacco products which contributed approximately \$3.1 billion in fiscal year 1995-96. Of this total, \$1.94 billion was attributable to tobacco, \$560 million to beer, \$480 million to spirits and \$110 million to wine.

The legislative framework governing the application of excise levies across alcohol and tobacco products is provided for in three separate statutes:

- The *Excise Act* imposes excise duties at various unit rates on domestically produced spirits, beer and tobacco products;
- The *Excise Tax Act* imposes excise taxes on both imported and domestic goods at a unit rate for wine and tobacco products and at an *ad valorem* rate for cigars; and
- The *Customs Tariff* imposes customs duties equivalent to the excise duties that are applicable to domestically produced goods, on imported spirits, beer and tobacco products.

The Department of Finance and Revenue Canada share responsibility for the federal commodity tax system. The Department of Finance is responsible for legislation and policy, while Revenue Canada administers the commodity taxation system, including interpretation, collection and enforcement.

The *Excise Act*

The *Excise Act* is the foundation of the federal commodity taxation system for alcohol and tobacco products. It imposes excise duties on spirits, beer and tobacco products manufactured in Canada and includes extensive control provisions relating to the production and distribution of these commodities.

The *Excise Act* is also one of the oldest taxing statutes in Canada, existing in previous configurations before Confederation and with parts of the present act flowing from the consolidated *Inland Revenue Act* enacted in the 1870s. This time frame for development and historically high rates of duty account for the positioning of excise duties as production charges, and also for the wide-ranging control provisions to ensure that excise duty is collected at a specific point in the production process.

For the most part, the imposition of excise duties and concurrent supervision of the alcohol and tobacco industries have functioned without undue difficulty over the course of

this century. While the administrative framework is comprehensive, the number of taxpayers is limited and participants have a body of specialized knowledge concerning application of the excise framework. Periodic amendments have dealt with specific issues, but the *Excise Act* has never been the subject of in-depth review and revision.

Impetus for Review

Recently, however, the need for a substantive review of the excise framework has become increasingly evident. Industry participants have undertaken significant development with respect to automated production processes, application of information technology systems, scheduling considerations, product marketing and distribution initiatives, and increased foreign competition.

Against this backdrop, industry associations representing distillers, brewers and tobacco manufacturers have expressed a number of recurring concerns with the *Excise Act*. Their fundamental position is that the archaic excise framework impairs their ability to achieve competitive commercial structures. Industry is seeking a revised framework that provides greater latitude to manage production and distribution processes in accordance with commercial pressures, and incorporates modern assessment and audit tools.

The Department of Finance and Revenue Canada recognize that changes are needed to update the structure of the *Excise Act*. In recent years, a limited number of changes have been introduced to both legislation and administration. For the most part, however, the government has been reluctant to make changes on an *ad hoc* basis, preferring to develop a comprehensive, integrated proposal that undertakes the type of fundamental change desired by government and industry.

There is also a need to consider the legislative and administrative structure governing the federal taxation of wine. Wine is taxed under the *Excise Tax Act*, which imposes a sales levy on the manufacturer without the type of close

supervision contained in the *Excise Act*. While the structure is less intrusive, there are concerns that this structure has not been effective in protecting government revenues and securing the integrity of the domestic market.

Thus, there is a strong desire on the part of government and industry to establish a new legislative structure and modern administrative approach that responds to the concerns and issues identified by the affected parties. The proposal for a revised excise framework will generate stable and secure revenues for the Crown and address recent contraband pressures, without imposing unrealistic administrative burdens on industry, or onerous controls on the manufacture of goods that fall under the legislation's jurisdiction.

In this way, the revised excise framework will foster the competitiveness of Canadian industries; minimize the role of government in the day-to-day affairs of business; provide Revenue Canada with increased opportunities to deliver a modern administrative function; and ensure that all applicable excise levies are accounted for in a fair and efficient manner.

Part II

Scope of the Review and Criteria for a Revised Excise Framework

Scope of the Review

The scope of the review is comprehensive, including both new legislation and an updated administrative function, but does not include rates of taxation.

To facilitate discussion on a wide range of topics, the Department of Finance and Revenue Canada entered into a consultative process with industry associations and provincial liquor jurisdictions. Some of the key areas discussed included:

- operational issues;
- administration;
- preventative considerations;
- treatment of imports; and
- production for personal consumption.

Several themes emerged through the consultative process, including the mutual desire to replace outdated supervisory controls and onerous administrative requirements with a modern approach based on self-assessment and after-the-fact verification. There was also a common recognition that the proposal for a revised excise framework must incorporate control measures sufficient to ensure the integrity of the production process; protect government revenues; and form the basis for an effective enforcement function.

Operational Issues

From an operational perspective, the *Excise Act* exerts broad, often outdated and intrusive supervisory controls over physical plant facilities, production processes, storage and transportation practices of Canadian manufacturers.

The need for strict supervision was originally based on the significant revenues raised through excise duties in the first half of this century, as well as the potential for diversion of non-duty-paid goods by marginal manufacturers. While these practices were consistent with the accounting and auditing practices of the day, their efficacy has been reduced by the technological advances realized across modern production processes. Retaining a strict supervisory framework is generally viewed by the alcohol and tobacco industries as an impediment to achieving greater operational efficiency.

The federal government recognizes that despite the marked changes in the operating practices of the alcohol and tobacco industries, few changes have been made to the legislative structure to respond to modern commercial practices. At the same time, any movement toward a new excise system must continue to ensure the integrity of producers and production, and provide the tools necessary to ensure that all excisable goods enter the domestic market on a duty- and tax-paid basis.

Administration

From an administrative perspective, the *Excise Act* is both archaic and arcane, posing serious problems for administration and compliance.

For many years, administration of the *Excise Act* was rooted in direct supervision of manufacturers through the presence of on-site excise officers. While this practice has been relaxed over recent years as Revenue Canada has updated its administrative function, the limitations of the *Excise Act* continue to constrain efforts in this regard. The structure of the act simply is not flexible enough to accommodate the increased use of information technology that is commonplace among government and industry. As a result, both government and industry are unable to achieve the efficiencies in administration and compliance that would provide a more certain, fair and effective taxation system.

A revised excise framework that incorporates the fundamental principles of self-assessment and after-the-fact verification

would allow administration and compliance in respect of excise levies to be brought up to the standards that currently exist among other taxes, facilitating Revenue Canada's integrated approach to all taxpayers and reducing the compliance costs to industry.

Preventative Considerations

The *Excise Act* performs an important preventative function with respect to the illicit production, distribution and possession of excisable goods. For the most part, this function has been realized, with domestic manufacturing and distribution of excisable goods characterized by integrity and respect for the requirements of the excise framework.

At the same time, specific taxation of alcohol and tobacco products and the potential for diversion continue to attract contraband pressures. Alcohol and tobacco products remain attractive to illegitimate operators, exerting a detrimental effect on industry, government and consumers. It is critical, therefore, that the revised excise framework be designed to achieve ongoing and greater efficiencies in the enforcement of provisions related to unauthorized production, distribution and possession of excisable goods.

Treatment of Imports

In addition to regulating domestic goods, the excise framework also extends to imported alcohol and tobacco products, whether in bulk form for further processing or packaged for retail sale.

There is general consensus among producers that the provisions governing the importation of foreign goods should not provide any competitive advantage over the domestic production of similar goods.

Industry and government share a common concern with respect to ascertaining the quality, quantity and destination of all import shipments and with a view to detecting and deterring any illicit undertaking.

Production for Personal Consumption

Recently, the production of beer and wine has included an increasing portion undertaken by individuals for personal consumption. Although this production is not intended for commercial use and still accounts for a small portion of total output, the rate of growth for this new industry has attracted the attention of both government and industry.

For years, this type of production was based in the home and undertaken on a small scale with rudimentary equipment. The cost of acquiring commercial quality brewing or fermenting apparatus, and the difficulty in securing the necessary raw materials, limited both the quantity and quality of production.

The establishment of commercial brew- or ferment-on-premises facilities in certain provinces, however, has brought about a fundamental shift in the method of production for personal consumption. These commercial operations provide the public with all the requisite raw materials, high quality equipment and technical advice necessary for the brewing of beer or fermenting of wine.

The services offered by these operations raise concerns about the application and integrity of the excise framework. There are questions as to what functions and level of service can be provided by the brew- or ferment-on-premises operator before the undertaking enters the realm of a commercial brewer or vintner. There is also a concern that the collection of commercial grade equipment in brew- or ferment-on-premises facilities and the quality of the final product create the potential for diversion of production away from personal to commercial use.

Criteria for a Revised Taxation Structure

The alcohol and tobacco industries have undergone change and modernization over the course of the last 50 years. Virtually all aspects of the commercial undertaking have been reworked. Production processes, financial and accounting systems, product development, marketing efforts and distribution networks are all geared toward creating competitive advantage in a changing, consumer-driven marketplace.

Other factors surrounding alcohol and tobacco products remain as prominent today as they were 50 years ago. Specific taxation of alcohol and tobacco products continues to contribute significant revenue to the federal government, while the nature of the products requires that the taxation function incorporate controls to protect the integrity of the domestic market, and respond to societal concerns over the production and disposition of these goods.

The challenge that faces government is to reform the legislative and administrative framework in a manner that recognizes and accommodates the needs of all parties. To assist in the development and assessment of possible taxation models, the following factors were identified as fundamental evaluation criteria:

- Control and protection of revenue – point of imposition for excise charges must provide a reliable and stable source of revenue and help to combat the contraband trade in alcohol and tobacco products;
- Modern administrative function – must be based in law and incorporate the concepts of certainty, consistency and a standard forum to contest assessments, as well as the ability to accommodate standard business systems and function under Revenue Canada's proposed integrated tax administration program;
- Ease of compliance – the legislative and administrative structure must be certain and simple, allowing for easy and accurate computations of tax liability and contributing to

the commercial efficiency of the alcohol and tobacco industries;

- Fairness – legislation and administration must treat participants in an equitable manner and address existing inequities under the current system; and
- Flexibility – the excise framework must be designed to recognize and respond to the significant shift in business practices and the impact of competitive pressures across the alcohol and tobacco industries.

These criteria represent a strong foundation for proposing changes to the excise framework that will enhance the efficiencies of both government and industry.

Part III

Production Levy Versus Sales Levy

Range of Options

The review was undertaken with a view to considering all options for a revised excise framework, ranging from a production levy to a sales levy. For purposes of the review, these levies may be defined as follows:

- Production levy – point of imposition up to and including finished-goods storage; and
- Sales or post-production levy – point of imposition subsequent to finished-goods storage, including removal from manufacturing premises or warehouse, point of sale by the manufacturer, or delivery to the wholesaler/retailer/consumer.

These options were evaluated against the criteria for reform outlined earlier and with reference to both domestic and international considerations.

International Comparisons

The taxation of alcohol and tobacco products is one of the oldest forms of taxation in the world. The broad base of global experience allows domestic reform efforts to consider the excise frameworks of other countries having similar industrial and social characteristics – the United States, the countries of the European Community, Australia and New Zealand.

All the countries surveyed continue to impose specific taxation on alcohol and tobacco products at the level of the manufacturer, either at some point during the production process or on the first sale of the goods for wholesale distribution. This structure continues even in countries with a greater reliance on a comprehensive value-added taxation structure.

There is general consensus among the surveyed countries that manufacturers should be licensed or registered and, in many cases, subject to some basic disclosure requirements in respect of premises and equipment. Beyond these basic requirements, the range of production controls and compliance mechanisms extends from on-site presence of revenue control officers, to modern audit systems implemented for extended time periods through a comprehensive systems-based investigation of the manufacturer.

Point of imposition and time of payment are largely integrated. Where point of imposition occurs at an early stage in the production process, time of payment can be delayed for several months to allow for production and distribution cycles. Where point of imposition occurs at a later stage, payment may be required with less delay, reflecting the shorter time to market.

There is a recognition that control and compliance techniques should reflect the use of automated production processes. The greater the degree of automation, the greater the need to test the system as opposed to individual transactions, and to perform accounting reconciliations over time. As manufacturers implement automated processes, excise frameworks around the world have been revised to meet this changing environment.

This brief survey of international excise structures, while not intended to be exhaustive or conclusive, highlights certain considerations that are useful for the development of a revised domestic framework.

At the most basic level, specific taxation of alcohol and tobacco products at the level of the manufacturer continues to be a prominent feature of the commodity taxation system in all the surveyed countries. While a variety of legislative and administrative structures are currently in use, the differences across concept, design and implementation tend to be attributable more to evolution than revolution, as each country attempts to balance the interests of protecting

government revenue, reducing the administrative burden, and allowing businesses the opportunity to implement competitive practices.

Domestic Considerations

It is important to remember that alcohol and tobacco are not like other products. Specific taxation and the potential for diversion act as powerful incentives for contraband activity and demand special consideration in the formulation of an excise framework that will protect the integrity of the domestic market and government revenues. In fact, over the time frame of the review, the domestic markets for alcohol and tobacco products were subject to considerable contraband pressure.

Tobacco

Significant amounts of contraband tobacco first appeared in the early 1990s with the diversion of untaxed product intended for duty-free sale in Canada and for export. To combat this activity, the stamping and marking requirements that accompany imposition of excise duty for tobacco products, and the controls on the sale of duty-free tobacco products in Canada, were revamped and strengthened in 1992.

Continued growth in Canadian tobacco products exported on a duty- and tax-free basis and smuggled back into the country, however, led to the implementation of further measures, including tax cuts, in 1994. Again, the stamping and marking requirements that accompany imposition of excise duty were fundamental to establishing differential excise rates by province and to successful prosecution of smuggling networks.

Spirits

In the case of spirits, control measures that accompany the imposition of excise duty at time of production have been largely effective in preventing illegal production and diversion of domestic production. Contraband activity has

focused on the smuggling of low-cost U.S. product for distribution through black market channels to consumers and commercial venues.

More recently, however, there has been some evidence of limited diversion of domestic production intended for export as contraband operators continue to put pressure on the control measures contained in the *Excise Act*.

Beer

With respect to beer, its mass and perishability form an effective physical barrier to the diversion or smuggling of bulk product, while imposition of excise duty at the time of packaging ensures that packaged goods, which can be more easily diverted, have liability for duty attached.

Wine

Wine is taxed under the *Excise Tax Act* and is subject to few controls over production and distribution. Against this backdrop, the contraband problem includes unlicensed production in Canada with illicit distribution to consumers and commercial venues. In addition, bulk wine fraudulently enters Canada and is bottled to supply the underground market. The *Excise Tax Act*, imposing liability only at the point of sale, does not provide the tools necessary to control this contraband activity.

Weaknesses of a Sales Levy

These developments have plainly demonstrated the need for a legislative structure that protects government revenues and secures the integrity of the domestic market. Shifting the point of imposition away from production would only exacerbate contraband pressures, reduce the potential for constructive federal involvement at the manufacturing level, and limit the tools available to enforcement agencies. Consider the following factors associated with a post-production levy:

- Packaged goods would be stored without imposition of duty, often at off-site private and public warehouses, increasing the number of participants and risk of diversion while reducing the manufacturers' incentive to safeguard production;
- Moving the point of imposition away from production would reduce the certainty of accounting reconciliations of production with amount shipped or sold; and
- Application of legal concepts to the determination of sale, delivery and purchaser would reduce the certainty of taxation assessment and collection, and create the potential for uneven application of the tax between and within provinces depending on the extent to which various wholesale and retail undertakings are available.

For these reasons, a sales levy does not provide the level of protection and enforcement required for specific taxation of alcohol and tobacco products. Moreover, any attempt to address the concerns surrounding a sales levy could result in an excise framework that is more complex and costly to administer than a production levy.

Strengths of a Production Levy

Work on the review has demonstrated that a production levy is essential to control and protect revenue, and that such a levy should include wine. Imposition of excise duty during the production process:

- Minimizes the risk of diversion of duty-free product by imposing a liability at a stage prior to the point where product can be easily redirected;
- Provides the opportunity for the federal government to maintain a constructive presence in production, packaging, storage and distribution;
- Ensures that manufacturers have a strong incentive to safeguard their production;

- Allows for a more effective enforcement function where goods are charged with excise duty at an early stage in the production process; and
- Complements provincial control over wholesale distribution and retail sale, effectively providing regulatory vigilance and enforcement capacity at all points along the production and distribution chain.

Revising the Production Levy

The retention of production-based excise charges does not, however, require the type of archaic structure and onerous regulation that comprise the current *Excise Act*. Many of the intrusive controls of the current legislation can be replaced with a modern production levy based on self-assessment and after-the-fact verification, while including the tools necessary to protect government revenues.

Part IV

Proposal for a Revised Excise Framework Imposition and Control Structures

Overview

Under the proposal for a revised excise framework, control and protection of revenue will no longer be achieved by regulating the apparatus and place of production, but rather by licensing and registering persons who own or possess bulk goods and by imposing penalties on unauthorized ownership or possession.

Excise duty will be imposed during the production process, but there will be fewer constraints on how and where a manufacturer may produce, store or transport goods, providing greater flexibility for producers and recognizing both public and private distribution needs.

The overall approach to imposition and control structures is one of balance – greater flexibility for industry to manage production practices in a competitive manner will be balanced by the government's ability to determine liability for excise based on the production and flow of bulk and packaged goods.

The sections that follow outline the key concepts of the revised excise framework as they apply to beverage alcohol, alcohol used for non-beverage purposes and tobacco products. More detailed information on an industry-specific basis is available in the attached technical annexes.

Alcohol

The proposal for a revised excise framework for alcohol introduces a broad range of new measures designed to provide distillers, brewers and vintners with a fair, modern and efficient taxation structure. The core elements of the new system are set out below.

Production Levy

- *Spirits, beer and wine will all be subject to an excise duty that is imposed and becomes payable during the production process.*
- *For spirits, excise duty will be imposed at the still and payable at the time of packaging.*
- *For beer and wine, excise duty will be both imposed and payable at the time of packaging.*

Point of imposition refers to the point at which goods are charged with excise duty. For spirits, excise duty will be imposed at the still. For beer and wine, excise duty will be imposed at the time of packaging. Earlier imposition for spirits reflects the fact that spirits are potable when they come off the still.

At the time excise duty becomes payable, the quantity of goods and amount of excise duty are determined, and responsibility to pay the excise duty is assigned to a particular person. For spirits, beer and wine excise duty will be payable by the owner of the goods at the time the goods are bottled or otherwise packaged for consumption.

Bulk Goods

- *Prior to packaging, excise duty is not payable on bulk alcohol.*
- *There will, however, be strict controls over ownership, possession and disposition of bulk alcohol, with penalties imposed for illegal ownership, possession and disposition.*
- *Mandatory licensing of the producers and owners of bulk alcohol, and registration of persons who will possess these goods, are key concepts.*
- *Only an excise licensee may own bulk alcohol and only an excise licensee or excise registrant may possess bulk alcohol – an excise licensee remains accountable for goods in the possession of an excise registrant.*

Excise duty will be imposed during the production process, but licensing of manufacturing premises and control of production equipment will no longer exist. Instead, there will be controls on the ownership and possession of bulk alcohol – goods which have not been bottled or packaged for consumption.

Regulating the ownership and possession of bulk alcohol is essential to maintaining the integrity of the excise system. The features outlined below form the basis for liability on diversion of bulk alcohol, imposition of penalties, and seizure of bulk alcohol found in possession of unauthorized persons.

An excise licence will be required by any person who produces or packages spirits, beer or wine (or who owns spirits, beer or wine produced or packaged on his or her behalf). This requirement also applies to provinces, except where a province takes ownership of alcohol only to comply with federal or provincial laws.

To provide excise licensees with increased flexibility to store and transport bulk alcohol, an excise registrant will be introduced. An excise registrant may possess and transport bulk alcohol it does not own, but does not assume liability for excise duty. The excise licensee who owns the bulk alcohol remains accountable for any losses that occur while the goods are in the possession of the excise registrant.

Alcohol produced domestically may be sold in bulk form by the excise licensee who owns the alcohol to another excise licensee. The purchasing excise licensee must further process or package the bulk alcohol, however, and cannot simply resell the goods as received. This restriction is designed to prevent "jobbing" of bulk alcohol and maintain the integrity of the flow of bulk goods.

Bulk alcohol may be imported by an excise licensee or a province. All imported bulk alcohol is subject to regular customs duty and Goods and Services Tax (GST) at the time of importation. Bulk spirits are also subject to customs duty equivalent imposed at the time of importation, which becomes

payable at packaging. For bulk beer and bulk wine, regular excise duty is imposed and payable at the time of packaging.

As per the restriction on sale of domestically produced alcohol, the excise licensee who imports bulk alcohol cannot simply resell the goods as received but must further process or package the bulk alcohol, again to preserve the integrity of the flow of bulk goods. In addition, bulk beer brought into a province by an excise licensee will continue to be subject to the blending provisions of the *Importation of Intoxicating Liquors Act (IILA)*.

Bulk alcohol that is to be exported free of duty must be exported by the excise licensee who owns the alcohol and must leave from the premises of the excise licensee who produced or further processed the goods.

Packaged Goods

- *Excise duty becomes payable when bulk goods are bottled or otherwise packaged for consumption.*
- *Packaged spirits and packaged wine may, however, be stored on a duty-deferred basis in an excise warehouse, with excise duty payable upon removal from the excise warehouse.*
- *There is no duty deferral in respect of beer intended for the domestic market.*

Excise duty will be payable when bulk alcohol is bottled or otherwise packaged for consumption. Packaged spirits and packaged wine may be entered for storage on a duty-deferred basis in an excise warehouse. This deferral reflects the storage and ageing period for wine and spirits, as distinct from beer, and helps to provide a level playing field among the alcohol industries.

An excise warehouse will be defined as specified premises, other than retail premises, where packaged spirits and packaged wine can be stored on a duty-deferred basis. A licence for an excise warehouse may be granted to excise

licensees and provinces. To facilitate privatization initiatives undertaken by some provinces, an excise warehouse licence will be available to any person who is not a retailer. This broad availability can be moderated by provincial restrictions on who may warehouse alcohol.

Once packaged spirits or packaged wine are placed in an excise warehouse, liability for excise duty will transfer from the owner of the goods to the excise warehouse licensee. Excise duty will be payable by the excise warehouse licensee when the goods are removed from the excise warehouse.

Removal of packaged spirits and packaged wine from an excise warehouse on a duty-free basis will be permitted only for delivery to duty-free stores, accredited representatives or for use as ships' stores. Where packaged spirits or packaged wine are to be exported on a duty-free basis, they must be removed directly from an excise warehouse of which the packaging distiller or vintner is the licensee.

In the case of beer, duty-deferral will not apply to product intended for the domestic market. Packaged beer may, however, be placed in an excise warehouse for delivery to duty-free stores, accredited representatives or for use as ships' stores. Where packaged beer is to be exported on a duty-free basis, it must be removed directly from an excise warehouse of which the packaging brewer is the licensee.

Imported packaged goods will no longer be allowed to enter a customs bonded warehouse. They will be subject to regular customs duty and GST, payable by the importer of record at the time of importation. The customs duty equivalent in respect of packaged beer is also payable at the time of importation.

For wine and spirits, payment of the customs duty equivalent may be deferred if the importer is an excise warehouse licensee and the wine or spirits are delivered to the excise warehouse by a customs bonded carrier. The customs duty equivalent is then administered in the same manner as the excise duty on domestic packaged spirits or wine.

Production for Personal Consumption – U-Brews and U-Vins

- *In order to possess the bulk beer and bulk wine which is produced on their premises by individuals and owned by the individuals for personal consumption, u-brew and u-vin operators will be required to register as excise registrants.*
- *To qualify for the personal use exemption, individuals must ferment and package the beer or wine that they own.*
- *U-brew or u-vin operators who ferment or package wine or beer will be required to secure an excise licence and will be liable for excise duty.*

Liability for excise duty rests with the owner of beer or wine at the time the goods are packaged. The only exception to this rule is where the owner of the beer or wine is an individual and the beer or wine was made for the individual's personal use and not for commercial use. (Spirits may be produced only by a licensed distiller.)

As a corollary to the controls on bulk alcohol outlined earlier, u-brew and u-vin operators will be required to register as excise registrants to possess the bulk wine or bulk beer which is produced on their premises by an individual solely for the individual's personal use.

To qualify for the personal use exemption, individual customers will continue to be required to ferment and package the beer or wine that they own. They will not be required to perform intermediate steps such as filtering, carbonation or racking which may be performed by the u-brew or u-vin operator.

U-brew and u-vin operators who ferment or package beer or wine for a customer will be required to secure an excise licence, and will be liable for excise duties on any beer or wine that they ferment or package for an unlicensed owner.

Comparison of Revised and Existing Frameworks

The proposal for a revised excise framework shifts the focus from rigid control over plant, apparatus and production processes, to the identification and movement of bulk alcohol among designated parties with liability for excise duty based on ownership.

For spirits and beer, currently subject to the expansive provisions of the *Excise Act*, the proposal for a revised excise framework will remove many of the intrusive forms of government involvement, providing distillers and brewers with greater flexibility to manage production and distribution in a modern manner. In addition, the new imposition and control structures will help to deter and detect contraband activity and facilitate the prosecution of contraband operators.

Wine is currently subject to a post-production levy, which has reduced the federal presence at the manufacturing level and impaired the potential for an effective enforcement function. The new taxation structure for wine will be more comprehensive, helping to address a significant illegal wine market and providing equitable treatment among the alcoholic beverage industries.

The proposal for a revised excise framework will continue to allow individuals to undertake the production of beer and wine for personal consumption, and u-brew and u-vin establishments to provide facilities and services to these individuals. New provisions regulating the storage of bulk goods and codifying the existing guidelines for production for personal consumption will help to preserve the integrity of the domestic market and ensure that all participants are on a level playing field.

Alcohol for Non-Beverage Purposes

The proposal for a revised excise framework will also apply to alcohol intended for non-beverage purposes. It is important to understand that there is no difference in the alcohol produced for beverage use and that produced for non-beverage

use – several producers make alcohol for both beverage and non-beverage use and all producers must be licensed.

Alcohol used for non-beverage purposes is generally spirits, although there are non-beverage applications for both beer and wine. Spirits intended for non-beverage use take one of three general forms:

- undenatured spirits which are potable;
- denatured spirits which are not potable; and
- specially denatured spirits which are not potable but can, through certain recovery processes, be made potable.

Current Framework

Under the current *Excise Act*, where denatured or specially denatured spirits are supplied for non-beverage use, the control function is carried out through the approval of end uses and denaturing standards.

Where undenatured spirits, beer or wine are supplied for non-beverage use, the risk of diversion is addressed by defining and regulating two categories of authorized participants, licensed manufacturers and registered users, and by approval of product formulas or specification of use.

These controls minimize the risk of diversion of alcohol for beverage use and address public health concerns. Without undertaking any fundamental changes to the control structures currently in place, a number of changes are proposed to rationalize and simplify the excise framework.

Producers of Alcohol for Non-Beverage Purposes

For producers of denatured and specially denatured spirits, the key proposal for a revised excise framework is a review of the denaturing standards.

Distillers will be able to produce more grades of denatured and specially denatured spirits to correspond more closely

with grades approved in the United States, and will also be allowed to produce grades for export to foreign specifications. In fact, this process has already begun, with the recent release by Revenue Canada of new regulations for denaturing standards.

Both denatured and specially denatured spirits will continue to be duty free. Denatured spirits will not be subject to further restrictions concerning sale or export, while specially denatured spirits may only be exported or sold to a holder of a permit issued by Revenue Canada for that particular grade.

Users of Alcohol for Non-Beverage Purposes

The ability to acquire and use duty-free spirits, beer or wine will continue to be determined in accordance with two categories of authorized users:

- Licensed manufacturers will be able to purchase spirits, beer or wine on a non-duty-paid basis in bulk or packaged form from a distiller, brewer or vintner or excise warehouse licensee, for use in a formulation or for a purpose approved by Revenue Canada; and
- Registered users will be able to purchase spirits on a duty-free basis, in packaged form only, from an excise warehouse licensee where the registered user is a qualifying health or educational institution or other person using spirits for scientific purposes.

Within the context of licensed manufacturers, Revenue Canada will be reviewing the process for formula approval to include new risk-assessment factors that extend beyond potability. This undertaking responds to concerns that the existing process is too rigid and will help to facilitate the introduction of new products and boost competitiveness of Canadian manufacturers.

In addition, administration and compliance will be addressed. Licensed manufacturers will no longer be required to hold separate licences for different classes of products, nor will

they be required to hold separate inventories of alcohol for each product category.

Finally, the nominal rates of excise duty that apply to alcohol for non-beverage use will be eliminated. These charges bring in less than \$2 million per year and do so in a manner that is inconsistent and onerous across the authorized participants. Accordingly, there will no longer be excise duty charged on alcohol used for non-beverage purposes.

Comparison of Revised and Existing Frameworks

The proposal for a revised excise framework for alcohol for non-beverage purposes will reduce complexity and promote fairness, while maintaining adequate controls to ensure that untaxed potable and potentially potable alcohol is not diverted to beverage use.

Production of alcohol for non-beverage use will be undertaken in accordance with the same rules that govern the production of alcohol for beverage use – excise licensees, excise registrants and excise warehouses.

Producers will benefit from specific changes designed to respond to technical and competitiveness concerns – they will be able to produce additional grades that correspond more closely with grades approved in the United States, and they will be allowed to denature spirits for export to foreign specifications.

Users of alcohol for non-beverage purposes will benefit from changes to the administrative structure surrounding their operations, with emphasis on formula approval and reduced compliance burden. In addition, the elimination of the nominal rates of duty will end the complex and inconsistent application of variable rates of duty across manufacturing uses.

Tobacco Products

The focus of the review for tobacco products is to establish a single excise levy. It is critical, however, that the revised excise framework provide a level of control and protection for federal revenue that is commensurate with high rates of specific taxation.

Current Framework

Tobacco products are the only goods subject to both a production levy and a sales levy, as set out in the *Excise Act*, the *Excise Tax Act* and the *Customs Tariff*.

A production levy is imposed on domestically produced tobacco products at the time of packaging and on imported tobacco products at the time of importation. Excise duty must be remitted at the end of the month excise duty is imposed.

A sales levy is imposed on domestically produced tobacco products at the time the manufacturer delivers the goods to a purchaser, and on imported tobacco products at the time of importation. Excise tax must be remitted at the end of the month following the month excise tax is imposed. Large manufacturers are required to remit excise tax at the end of the month the tax is imposed and on the 15th day of the following month.

The application of separate rules for imposition and remittance under three statutes results in excessive compliance and administration costs.

Control and Protection of Revenue

Control and protection of revenue is the most important consideration shaping the proposal for a revised excise framework for tobacco products. The large scale contraband trade during the early 1990s plainly illustrated the vulnerability of tobacco tax revenues.

Under the existing excise framework, control and protection of revenue is safeguarded by the provisions of the *Excise Act*.

The stamping and marking requirements that accompany imposition of excise duty play an essential role in protecting tobacco tax revenues. The risk of non-duty- and tax-paid product being diverted into the domestic market is minimized because excise duty is imposed, and the stamping and marking requirements must be complied with, at the time tobacco products are packaged or imported.

Enforcement measures against contraband tobacco rely heavily on the stamping and marking requirements for tobacco products. The *Excise Act* stipulates that the absence of tobacco stamps on a tobacco package is evidence that excise duty and tax have not been paid, facilitating prosecution of persons who are found in possession of unstamped tobacco products.

New Excise Duty

The federal proposal for creating a single levy on tobacco products is to roll both excise tax and customs duty equivalent into excise duty.

The new excise duty will be imposed on domestically produced tobacco products at the time of packaging, and on imported tobacco products at the time of importation. There will be only one set of rules for imposition and excise duty will be remitted at the end of the fiscal month following the fiscal month excise duty was imposed.

Deferral of duty will continue to be available for domestic and imported tobacco intended for duty-free sale. The system will be streamlined by consolidating the current functions performed by excise bonding and customs bonded warehouses into an excise warehouse. This new system for duty deferral will result in equal treatment for domestic and imported tobacco products.

The critical advantage of the new excise duty is the continued application of stamping and marking requirements for tobacco products. Domestic and imported tobacco products will be stamped at the time of packaging to ensure that duty has been paid at the rates applicable in the province where the tobacco

is to be sold for consumption. Domestic and imported tobacco products entering an excise warehouse will be marked to reflect the fact that they are intended for duty-free sale.

In addition, modern administration and compliance structures will provide a more fair and efficient taxation structure for industry and government.

Part V

Proposal for a Revised Excise Framework

Administration and Compliance

In addition to the broad structural changes that will establish new control features and help to protect the integrity of the domestic market, the revised excise framework for alcohol and tobacco products also includes substantive changes to key administrative functions.

Remittances, returns, collections, assessments and appeals will all be revised to reflect a modern approach to administration, with emphasis on reducing the compliance burden and increasing efficiencies for industry and government.

Remittances and Returns

The current system of remittances and returns is not efficient – remittances and returns are due on different dates; their timing does not correspond with other taxes and charges; and there is little co-ordination with commercial accounting periods.

To improve this situation, the system of remittances and returns for excise duties will be harmonized with other taxes and commercial accounting periods. These changes are consistent with Revenue Canada's planned integrated accounting system, which anticipates the alignment of due dates of various payments.

Under the new system, returns must be filed no later than the last day of a fiscal month for excise duty that became payable during the previous fiscal month – a fiscal month will be the same as for the GST.

For beer and tobacco products, remittances will be due at the end of the month following the month of packaging. For spirits and wine, remittances will be due at the end of the

month following the month of removal from an excise warehouse.

For beer, spirits and tobacco products, the proposed changes will extend the average time for remittance. For wine, excise duty will now be remitted by provincial liquor boards, extending the average time for remittance for some vintners and provincial liquor boards.

Collections

Historically, excise officers maintained strict control over the collection of excise duty. Production equipment was kept under government lock and key, and excise stamps to be affixed to tobacco products and spirits were sold by the excise officer to the manufacturer before daily production could begin. Brewers were also required to pay duty to the excise officer each day. As a result, the *Excise Act* does not contain any collection tools – if excise duty was not paid the excise officer could simply lock the plant.

Further protection of government revenues was provided by the requirement that all excise licensees post guarantee bonds as a condition of their licence. To the extent that arrears of duty were tolerated, Revenue Canada could call the guarantee bond, effectively causing closure of the establishment unless the licensee was able to obtain another bond.

Over the years, this philosophy of strict control has been gradually relaxed, culminating in regulatory changes in 1991 that allowed for monthly rather than daily remittance of excise duties. Guarantee bonds, however, have remained part of the excise duty structure but not without comment from industry. In fact, there are good reasons for reconsidering the requirement that excise licensees post a guarantee bond.

Traditionally, the amount of the bond represented a licensee's average daily remittance. With the shift to monthly remittance, however, the minimum and maximum bond amounts are rarely an accurate reflection of one month's duty. For large taxpayers, the maximum amount is less than one

month's duty while for small taxpayers the minimum amount is more than one month's duty.

Even where the bond amount approximates one month's duty, Revenue Canada's current collection procedure is to work with the taxpayer in an attempt to keep production going while making arrangements for payment of outstanding duty. During the course of this process, months can go by and arrears are often in excess of the bond amount.

Based on these considerations, the proposal for a revised excise framework will contain two key changes in respect of collections – the elimination of guarantee bonds (except in limited circumstances such as non-resident licensees) and the inclusion of a range of modern collection tools similar to those found in other tax legislation. Some examples of modern collection procedures are certificates of default, garnishment, seizure and sale of goods and chattels, and directors' liability.

Even with the inclusion of these collection mechanisms, it is anticipated that in many cases Revenue Canada's informal collection procedures will be sufficient to negotiate a payment schedule or arrange security for the payment of amounts due.

Assessments

Assessment provisions, like collection tools, do not currently exist in the *Excise Act*. During the time when on-site excise officers collected duties either before daily production or at the end of each business day, there was no need for a formal assessment procedure. If duties were not remitted as required, the excise officer could lock the plant until payment was made.

Today, these strict controls do not reflect the attitude of the government toward excise licensees, nor the fact that these industries are generally comprised of compliant taxpayers. In place of these antiquated provisions, modern assessment tools similar to those found in other taxing statutes are required.

The revised excise framework will be founded on voluntary compliance by excise licensees who will be expected to calculate and remit duty along with their periodic returns, without prior assessment by the Minister. To ensure that duties are properly calculated and remitted, the legislation will give broad audit and assessment powers to Revenue Canada.

Following an audit of production records, Revenue Canada will be able to raise an assessment where it is determined that the amount of duty remitted does not accurately reflect the amount of duty payable. The notice of assessment will set out the amount of duty payable or remittable, or the amount of any refund or rebate owing to the licensee. An objection to the notice of assessment may be filed in accordance with the formal assessment provisions which will be in the revised legislation.

Appeals

The existing *Excise Act* does not contain an appeals system. This deficiency reflects the fact that the legislation was adopted in an era prior to the development of modern tax systems.

The revised excise framework will include a judicial appeals system similar in principle to the appeals systems currently used for income tax and GST appeals. It will allow taxpayers to have certain decisions of the Minister of National Revenue reviewed by an impartial tribunal. This will provide an important safeguard for ensuring fairness in the treatment of taxpayers. In addition to the judicial appeals system, Revenue Canada will provide an administrative process for resolving disputes.

Under the new excise legislation, a taxpayer will have a right to file a notice of objection if the taxpayer disputes a particular assessment made by the Minister. After receiving the notice of objection, the Minister will review the assessment and decide whether to vacate, confirm or vary the assessment and will send a notice of decision to the taxpayer.

If the taxpayer is dissatisfied with the decision, the taxpayer may commence an appeal by filing a notice of appeal.

Appeals will be heard by the Tax Court of Canada. The Court will have the power to dismiss an appeal, cancel an assessment or refer an assessment back to the Minister for reconsideration. In certain circumstances, a taxpayer will have the option to elect to have an appeal heard in accordance with the Tax Court's informal appeals procedure, which allows appeals relating to smaller matters to be dealt with more quickly and efficiently. Decisions of the Tax Court may be reviewed by the Federal Court of Appeal.

Part VI

Proposal for a Revised Excise Framework Revenue Canada Administration

Parts IV and V of this paper set out the proposal for a revised excise framework in terms of imposition and control features, and administration and compliance. The broad structural changes that are proposed in these areas will be implemented by new legislation and delivered through the administration functions of Revenue Canada.

The proposal for a revised excise framework provides new opportunities for administrative efficiencies on the part of both industry and government. In fact, the administrative interaction between industry and government is critical to the realization and success of the new excise system. In the following sections, Revenue Canada's approach to administering the new excise system will be outlined.

Background

For some years, Revenue Canada has found it increasingly difficult to administer the archaic provisions of the *Excise Act*, and has agreed with industry's assessment that the legislation needs to be revised. Over this time, Revenue Canada has implemented such administrative and regulatory reforms as could be carried out under the authority of the existing legislation. Recognizing that additional reforms and a new approach to administration require wholesale legislative change, Revenue Canada has committed resources to the development of a new excise structure in conjunction with the Department of Finance and industry associations.

The importance Revenue Canada attaches to the development of a new excise framework is reflected in its current *Corporate Plan*, which sets out strategic goals for the fiscal years 1995-96 through 1997-98, as well as a clear strategy and key initiatives being undertaken to achieve each of them. One of the key initiatives highlighted in the *Corporate Plan* is the completion of the excise review.

The review is an important vehicle for change because it will deliver reforms on a number of fronts, each of which feeds into broader Revenue Canada initiatives. Examples of such initiatives include the integrated collections strategy, the comprehensive service quality strategy and the comprehensive compliance strategy.

Deficiencies in the Legislation From an Administrative Perspective

The overall philosophy behind the *Excise Act* is one of rigorous control and strict adherence to a set of prescribed rules to ensure that revenue to the Crown is maximized. These philosophical underpinnings are illustrated by the following references from the current law:

- No erasure shall be made in any books required to be kept ... and any obliterating of words or figures ... other than by ruling through them with ink in such a manner as not to render the words or figures so ruled out incapable of being read, shall be deemed to be an erasure (section 34);
- ...when two or more methods for determining quantities or the amount of duty to be paid are provided for, the method that yields the largest quantity or the greatest amount of duty shall be the standard (section 42); and
- Alterations may not be made to premises without written notice served on the collector at least one week before they are commenced (section 26).

This supervisory structure is at odds with current accounting and collection practices applied across other taxes, where the accepted norm is to provide for self-assessment by the taxpayer, with periodic audit by the government revenue authority including assessment powers and collection tools.

Moreover, unlike other federal tax statutes, the *Excise Act* provides no formal appeals process for taxpayers to make representations and seek redress against administrative actions or decisions of Revenue Canada. While the adoption of flexible regulatory provisions and administrative

arrangements agreed to by Revenue Canada and taxpayers have helped extend the life of the act, there is no denying that the legislation is fundamentally out of step with a modern tax administration.

Revenue Canada's New Approach to Administration

The rigid structure of the *Excise Act* has become an impediment to both competitive operating structures for industry, and the types of reforms being carried out under Revenue Canada's administrative consolidation, such as the implementation of an integrated accounting system.

The savings that should accrue to taxpayers and government from the recent consolidation of the two previously separate Departments of National Revenue (Customs & Excise and Taxation) cannot be fully realized without legislative amendments to remove structural rigidities and standardize such things as collections provisions, and accounting and remitting periods, across various taxes.

The proposal for a revised excise framework will allow Revenue Canada the opportunity to implement a modern administrative approach based on self-assessment by the taxpayer and after-the-fact verification through the audit process. The following sections provide an outline of how this new approach will be implemented across key areas.

Licensing

Producers

The current law requires a separate application and licence for each premise. Under the new structure, it is the person rather than the physical premises who will be licensed. A single excise licence will allow a person to operate from a number of premises providing Revenue Canada is notified before a new location is put into operation.

In addition, there will no longer be separate licences for each category of product – one generic producer's licence will allow the licensee to produce any excisable product. The person applying for a licence must specify which product(s) are intended to be produced and notify Revenue Canada when they intend to produce a new category of product.

This approach to licensing the person is consistent with Revenue Canada's initiative to implement the single "business number", which will provide a unique client identifier to a business and replace the various account numbers Revenue Canada currently assigns to clients for corporate income tax, GST, payroll deductions and so on. Assignment of a unique business number to each client will facilitate fast and efficient, single-window service to taxpayers.

The new structure anticipates fewer requirements and a more streamlined process for approval and issuance of licences. The requirement for guarantee bonds will be eliminated as will the onerous and somewhat arbitrary requirements for pre-licensing submission of information. The Minister will retain the power to refuse or revoke a licence but the criteria for exercising that power will be formalized. Applicants will be screened and may be refused a licence, for example, on the basis of prior criminal activity, including convictions for offences under the new legislation or under related legislation. A licence may be revoked on similar grounds, as well as for failure to comply with the terms, conditions and obligations of the licence.

Shifting the emphasis away from screening requirements for prospective licensees will allow Revenue Canada to direct resources and attention toward activities that will ensure maintenance of good compliance records by existing licensees. This more facilitative approach at the front end will be balanced by the availability of collection tools mentioned earlier, and an approach to audit and compliance that is based on the risk profile and performance record of licensees.

Registrants

Certain features of the proposed excise framework will extend more flexibility to excise licensees to organize their operations and arrange their business affairs. An example is the proposal to create an "excise registrant" who may possess and transport bulk goods which it does not own and on which, by definition, excise duty has not been paid.

Approval of excise registrants will involve a simple registration process, given that excise registrants will not be taxpayers and that liability for excise duty will remain with the excise licensee who owns the bulk goods. There will, however, be sanctions imposed on excise registrants who fail to comply with the record-keeping and documentation requirements of the new legislation. These requirements, coupled with restrictions over ownership and possession of bulk goods, are critical to maintaining protection over revenue in the new excise duty framework.

Warehouses

Other examples of the flexibility in the proposed excise framework may be found in the warehousing of excisable products. Licensing approval and operating requirements will be simplified and streamlined to facilitate implementation of these initiatives.

Currently, there are two types of warehouses provided for under separate legislative and administrative authority – customs bonded warehouses under the *Customs Tariff* for imported goods, and excise bonding warehouses under the *Excise Act* for domestically produced goods.

These warehouses will be replaced by a single "excise warehouse" for alcohol and tobacco products that may be used to store both domestic and imported packaged goods. Storage on a duty-deferred basis will be available for packaged wine and spirits, but not packaged beer or tobacco products, where the goods are intended for the domestic market. All packaged excisable goods may be stored on a duty-deferred basis in an

excise warehouse where the goods are for duty-free sale or export.

A warehouse operator will be required to secure only one excise warehouse licence, regardless of the number of separate physical facilities owned or the classes of goods (spirits, beer, wine or tobacco) being stored. The excise warehouse licence holder will, however, be required to notify Revenue Canada when a new warehouse location is established or a new category of product is to be stored in a given warehouse.

The excise warehouse licensee will not be required to post security to guarantee payment of the duties on products being stored, but will be held liable for outstanding duty on any unaccountable losses of those products, including theft. This new administrative approach will eliminate the need for physical controls and security requirements for warehouses, most notably those contained in the *Excise Warehousing Regulations*.

The new legislation will establish basic requirements for obtaining a licence. Where an application is rejected, the reasons will be made clear to the applicant and the applicant will have an opportunity to respond to the decision. Similarly, the grounds for suspension or cancellation of a licence will be formalized, and a licensee will have the right to respond before such action is taken.

Eliminating alcohol and tobacco products from customs bonded warehouses will allow these facilities, which have recently been re-engineered under the federal government's duty-deferral initiative to facilitate value-added activities and economic development opportunities for Canadian business, to operate without restrictions designed specifically for alcohol and tobacco products.

At the same time, Revenue Canada's control over alcohol and tobacco products will be enhanced because of greater certainty over who is holding and distributing duty-free products through excise warehouses. The only added administrative burden will be a requirement for an additional

licence for a small number of customs bonded warehouse operators who deal in both excisable and non-excisable goods (e.g., ships' chandlers and airlines).

Manufacturers

Streamlining will also take place in the area of licensed manufacturing or use of alcohol for non-beverage purposes. Under current legislation, licensed manufacturers must obtain a separate licence for each class of product and must maintain separate inventories of spirits, as well as separate books and records. Under the proposal for a revised excise framework these requirements will be removed and only one licence will be required.

In addition, Revenue Canada will simplify its formula-approval process in consultation with the distillers and licensed manufacturers who are authorized to produce and use alcohol for non-beverage purposes. Revenue Canada will establish an industry working group to recommend changes to the existing approval process, with particular emphasis on the approval criteria to be applied. The new process should provide licensed manufacturers with improved service consistent with continued revenue protection and safeguards against diversion of alcohol to illegal beverage applications.

Accounting Requirements and Returns

Under the proposal for a revised excise framework, restrictions on the location and security of premises of excise licensees are being abolished, and more flexibility is being extended to licensees to arrange for production, storage and distribution of their goods.

Because the integrity of the new tax system depends on after-the-fact verification of the activities of excise licensees and registrants, strict legal requirements for record-keeping will be established and enforced.

The current requirements for books and records will be reviewed in consultation with taxpayers, to ensure that the

new requirements are reasonable, relevant and, to the greatest extent possible, consistent with the records and reports that are already being generated for internal control purposes. The emphasis for these new requirements will be on content rather than format.

A return will be required from every taxpayer for each (monthly) accounting period. There may also be requirements, periodically, for "information returns" regarding the production, importation or movement of excisable goods. Given the need to monitor the production and movement of high-value goods on the basis of audit activity, up-to-date information on their status and disposition will be critical.

Audits

Under the current excise duty program, the audit approach used is consistent with the overall philosophy of the legislation mentioned earlier – strict control and maximization of revenue. This is accomplished by an audit and surveillance program that constitutes across-the-board coverage of a licensee's production and disposition of goods over a relatively short cycle by normal audit standards.

A surveillance is in essence a mini-audit that ensures more frequent physical presence of duty officers in licensed premises. The surveillance program was initiated as a transitional measure when on-site supervision was phased out some years ago. The theory is that early detection of errors will help reduce any ultimate assessment against the taxpayer.

In practice, the current program has been a source of frustration for some taxpayers because it represents an "audit for assessment" rather than an "audit for compliance" mentality and approach. It is often viewed as setting an overly rigid, even punitive, standard in relation to any reasonable audit objective of satisfying that a taxpayer is in compliance with standard norms and expectations regarding self-assessment.

For Revenue Canada as well, this approach may not represent the most cost-effective deployment of resources. Audit resources are spread thinly given this broad coverage and, despite this exclusive reliance on real-time or on-site auditing, there are no material assessments from most of these audits and surveillances.

Revenue Canada's approach under the new proposals will be based on audit for compliance and audits will be results driven. Under this philosophy, audit activity will be concentrated in areas that represent the highest risk to revenue. This will involve stratifying clients for audits according to risk-based criteria, including previous experience for new licensees, established compliance performance for existing licensees, and the amount of revenue potentially at risk. The resulting risk profiles will drive the audit program and determine where resources will be concentrated.

The elimination of redundant and non-revenue-related legislative requirements under the revised excise framework will allow audit activity to focus exclusively on material issues. In addition, audit activity will need to be strengthened and expanded into new areas where the revised excise framework allows new initiatives, such as storage of duty-free goods in excise warehouses and the creation of new participants such as excise registrants.

The audit approach, as well as the skills and training of responsible audit staff, must ensure that audits will be delivered in a manner that is appropriate and convenient to the circumstances of the individual taxpayer. Some taxpayers are large firms which operate sophisticated, automated accounting systems for their own internal accountability. In these cases, audit staff will generally conduct systems-based audits using statistical sampling techniques. Other taxpayers are smaller businesses that continue to rely on manual, paper-based systems. In those cases, more traditional audit approaches will continue to be the norm.

Assessments

An integral part of any modern taxation structure based on self-assessment and after-the-fact verification is the ability of the taxation authority to assess for amounts owing where it is determined, following an audit process, that the taxpayer has not properly accounted for the tax liability.

Under the proposal for a revised excise framework, Revenue Canada will have a broad assessment authority. Given that excise duty will be imposed during the production process and payable at the time of packaging, the fundamental reconciliation will be to determine whether the quantity of goods actually packaged exceeds that reported to have been packaged.

The assessment authority will allow assessments based on the difference between what was reported to have been packaged, and what was produced and should have been packaged. These assessments would be similar to the approach used for "net worth" assessments under the *Income Tax Act* where the taxpayer's books and records are not reliable or do not exist.

Offences

Under the revised excise framework, only excise licensees and excise registrants may possess bulk goods. This new control structure allows for the creation of an offence for simple possession of bulk goods, including wine, by unauthorized persons. These persons will be liable for penalties as well as forfeiture and seizure of the goods.

This control structure for bulk goods, the elimination of the small manufacturer's exemption from licensing and payment of excise tax, and the imposition of excise duty at packaging, will assist federal and provincial law enforcement agencies in their efforts to combat the growing problem of smuggling and illegal production of wine.

Until now, the delay in imposing excise tax until delivery or sale by the vintner, and the small manufacturer's exemption, made it difficult to affix liability for tax and provide evidence

sufficient to convict for alleged illicit activities. The new offence provisions will be simple and certain and evidence sufficient to convict will be easier to obtain. In fact, these provisions will parallel the existing possession offences for tobacco.

A common offence base and evidentiary requirements similar to those applied to other excisable goods, should ensure that the impact of the federal government's anti-smuggling initiatives will extend to include smuggled and illegally diverted wine. Stronger enforcement will benefit legitimate wine producers whose markets have been undercut by the criminal activities of others.

Collections

The bonding provisions of the *Excise Act* will be abolished, except for non-resident taxpayers who elect to become licensed, and replaced with more modern collections provisions already contained in the *Income Tax Act* and the *Excise Tax Act*.

These new provisions will provide collections officers with the ability to handle outstanding accounts in an effective manner, consistent with the other taxes that Revenue Canada administers. It will also ensure fair and equitable treatment of taxpayers under different taxing statutes.

Excise duty in arrears will be subject to the same actions as arrears of other taxes. For example, Revenue Canada will be able to setoff arrears of duty against refunds or rebates of other taxes that would otherwise become due to the taxpayer. Similarly, when a taxpayer fails to meet an obligation to pay excise duty in arrears, garnishment action will be possible against amounts owed to the taxpayer by other persons.

Given these collections tools and an integrated departmental approach to this function, it is anticipated that the new collections program will be delivered in a more cost effective and less intrusive manner than has been possible with the

administration of guarantee bonds, which impose transactions costs on all participants.

Appeals

The proposal for a revised excise framework includes a legislative appeals process. In addition, this formal appeal process will be complemented by an informal administrative process within Revenue Canada.

Informal review will be available to any of Revenue Canada's clients at an early stage regarding any matter in dispute, whether monetary or administrative. Such informal review will be less structured than the formal, statutory-based process. The key element will be the client's access to an intermediary within Revenue Canada who is structurally independent from the group making the decision in dispute.

This will provide an opportunity for a second opinion on the matter, with an earlier and less expensive resolution than under the formal appeal system. At the same time, it will not preclude eventual recourse to the formal system if the matter cannot be resolved satisfactorily.

Part VII

Summary and Conclusions

Summary

The current excise framework comprises an extensive system of pervasive controls on the production, importation and distribution of alcohol and tobacco products, focusing on the premises where excisable goods are processed or stored rather than the person who owns or controls the goods. The system is rigid and does not easily accommodate change and the implementation of modern business practices.

Brewers, distillers and tobacco manufacturers have indicated that the modern operating environment demands a more flexible framework with less onerous controls and minimal interference with business practices. Vintners have expressed concern that the excise framework does not provide the requisite level of protection necessary to ensure the integrity of the domestic market.

For its part, the federal government recognizes that the current excise framework is outdated and that the archaic legislative structure poses significant operating and administrative difficulties for all parties, including government. There is a recognition that the issues surrounding control and protection of revenue can be addressed, and the integrity of the domestic market strengthened, without imposing an onerous supervisory structure on industry participants.

The revised excise framework put forth in this paper proposes new legislative and administrative structures that will replace strict supervisory control with self-assessment and after-the-fact verification. Critical to the proposed framework is the ability to trace the production, flow and disposition of bulk and packaged goods, complemented by an enforcement function that imposes sanctions where goods are not accounted for within the parameters of the new system.

Conclusions

The proposed framework responds to the concerns expressed by industry and government in a responsible and constructive manner. Returning to the criteria and objectives discussed earlier, the following observations can be made:

- Control and protection of revenue – will be achieved through a production levy that emphasizes the flow of goods and creates the requisite base for a strong enforcement function;
- Modern administrative function – will be based on a new legislative framework and founded on voluntary compliance and self-assessment, and will incorporate modern assessment, collection and appeal provisions;
- Ease of compliance – changes to time and method of remittance will harmonize excise requirements with commercial accounting practices and with other taxes and charges;
- Fairness – the comprehensive scope of the review process helps to ensure equitable treatment for the alcohol and tobacco industries; and
- Flexibility – will be fostered through taxation and control structures that focus on ownership and possession of bulk and packaged goods rather than on the minutiae of production and other functional issues.

In conclusion, the comprehensive proposal for a revised excise framework will provide manufacturers with an enhanced ability to manage their production and distribution processes, while allowing government the opportunity to monitor the flow of bulk and packaged goods to determine liability for excise duty. The means for implementing these changes will be new legislation that provides the tools necessary to protect revenue and combat contraband activity, delivered through a more certain and fair administrative function. The outcome is greater efficiency and equity for all parties.

Part VIII Process

Consultations and Submissions

Shortly after the release of this paper, officials of the Department of Finance and Revenue Canada will meet with industry associations and representatives to answer their questions concerning the revised excise framework.

The government also welcomes additional comments on its proposal. Interested persons are invited to send written submissions on or before March 14, 1997 to:

Excise Act Review Group
Revenue Canada and the Department of Finance
15th Floor – East Tower – 140 O’Connor Street
Ottawa, Ontario
K1A 0G5

Government officials will review the written submissions and will consider possible modifications to the proposed excise system. After reviewing the submissions, officials will be available to meet with interested parties.

Parliamentary Consideration and Implementation

The government intends to table a bill for a new excise system for parliamentary consideration in the fall of 1997. In order to meet this target, drafting work on the legislation has begun and will continue through the consultation process.

In addition to tabling the bill, there are a number of other steps involved in implementing the new excise system, including drafting regulations and developing administrative policies and procedures. Consequential amendments to the *IILA*, *Customs Act* and *Customs Tariff* will also be required.

Subject to parliamentary approval, the expected implementation date for the new excise system is July 1, 1998.

Technical Annexes

Annex I

Excise Duty on Spirits

Introduction

The proposal for a revised excise framework will impose a production levy on spirits. The new system, however, will be significantly different in design and application from the current system, which relies on pervasive controls over the premises and equipment used to produce spirits.

The focus of the proposed tax structure will be the control of ownership and possession of bulk spirits, combined with a modern administrative system and an audit approach based on self-assessment and after-the-fact verification of books and records.

A. Licensees and Registrants

A.1. Excise Licensee

Under the proposed excise system, a distiller is defined as any person who produces, denatures or packages spirits or who owns spirits at the time they are produced, denatured or packaged. Any person who carries on the activities of a distiller in Canada will be required to obtain an excise licence and will be referred to as an excise licensee.

A non-resident who owns spirits at the time they are produced in Canada is a distiller and will be required to be licensed and post a guarantee bond. A non-resident owner who ships bulk spirits into Canada to an excise licensee for packaging or denaturing will not be required to be licensed, but may apply to be licensed, subject to posting a guarantee bond.

Excise licensees will be required to maintain books and records related to the production, processing, packaging and sale of spirits. An excise licensee must also maintain records related to bulk spirits that are owned by the licensee but are possessed by another excise licensee or an excise registrant.

A.2. Excise Registrant

An excise registrant is any person registered with Revenue Canada to possess or transport bulk spirits that are owned by an excise licensee, a licensed manufacturer, a province or, in the case of imported bulk spirits, an unlicensed non-resident.

The excise registrant does not assume liability for excise duty in respect of the bulk spirits – the owner or importer remains accountable for bulk spirits that are possessed by an excise registrant.

While excise registrants will not be required to provide notification for each movement of bulk spirits, they will be required to maintain books and records that will enable Revenue Canada to verify movements of bulk spirits. Registrants will also be required to maintain information on the ownership of bulk spirits in their possession. In the case of imported bulk spirits owned by an unlicensed non-resident, excise registrants must maintain information identifying the excise licensee or licensed manufacturer who imported the bulk spirits.

A.3. Excise Warehouse Licensee

An excise warehouse licensee is any person authorized to acquire and store packaged spirits on a duty-deferred basis in premises specified under its licence as an excise warehouse.

Three classes of persons may apply for an excise warehouse licence – excise licensees, provinces and persons who are not retailers. In general, any premises (except retail premises) used to supply packaged spirits to two or more retail stores or other excise warehouse licensees will be eligible to be an excise warehouse.

An excise warehouse licence will also be issued to a person in respect of a warehouse used to supply spirits to the export or duty-free markets, or to licensed manufacturers and registered users.

A.4. Licensed Manufacturer

A licensed manufacturer is a person licensed under the *Excise Act* to own and possess non-duty-paid bulk or packaged spirits for further manufacturing or processing of products in formulations approved by Revenue Canada, or for use in a manufacturing process in which the spirits are completely destroyed.

A.5. Registered User

A registered user is a person authorized by Revenue Canada to acquire and use packaged spirits duty free for scientific or medicinal purposes.

Further discussion concerning the treatment of spirits for non-beverage uses by licensed manufacturers and registered users can be found in the annex entitled, “Industrial or Non-Beverage Use of Spirits, Wine or Beer”.

B. Basic Operation

B.1. Domestic Spirits

Under the proposal for a revised excise framework, excise duty will be **imposed** on the quantity of spirits produced in Canada. Liability for excise duty will rest with the owner of the bulk spirits and will transfer with any change of ownership.

Excise duty will become **payable** when the bulk spirits are bottled or otherwise packaged for consumption. When bulk spirits are taken for a taxable use by an excise licensee or a licensed manufacturer without being packaged, the excise duty will become **payable** at that time.

The payment of the excise duty may be **deferred** if, immediately after packaging, the spirits are placed in an excise warehouse. Liability for payment of excise duty will transfer from the owner of the spirits to the excise warehouse licensee who has possession of the packaged spirits. Excise duty will be **payable** when the spirits are removed from the

excise warehouse unless they are exported, sold to a licensed manufacturer, a registered user or the duty-free market, or transferred to another excise warehouse.

The excise duty will be **remittable** by the last day of the month following the month in which it became payable.

B.2. Imported Spirits

Excise duty will not apply to bulk or packaged spirits that are imported. Instead, a customs duty equivalent to the excise duty will be imposed under the *Customs Tariff* at the time of importation, with liability resting with the importer.

For imported bulk spirits, the customs duty equivalent will be administered in the same manner as the excise duty on domestic spirits – the customs duty equivalent will be payable when imported bulk spirits are packaged, unless the packaged spirits are placed in an excise warehouse. Alternatively, duty will be payable when bulk spirits are taken for use. Where imported bulk spirits are packaged and then placed in an excise warehouse immediately after being packaged, duty will be payable when the spirits are removed from an excise warehouse.

In the case of imported packaged spirits, the customs duty equivalent will be payable at the time of importation according to customs rules, unless the importer is an excise warehouse licensee and the packaged spirits are delivered by a customs bonded carrier directly to an excise warehouse. For imported packaged spirits entered into an excise warehouse, customs duty equivalent will be administered in the same manner as the excise duty on domestic product – duty will be payable when the packaged spirits are removed from an excise warehouse.

Under the proposed excise system, imported bulk and packaged spirits will no longer be allowed to enter a customs bonded warehouse. The regular customs duty and GST will be payable at the time of importation under normal customs rules and procedures.

C. Treatment of Bulk and Packaged Spirits

C.1. Bulk Spirits

Bulk spirits will always be non duty-paid. A key feature of the new structure will be the rules regarding the ownership, possession, disposition and importation of bulk spirits.

Ownership of Bulk Spirits

Bulk spirits may only be owned by an excise licensee, a licensed manufacturer, a province or, in the case of imported bulk spirits, an unlicensed non-resident owner.

Ownership of bulk spirits may be transferred from one excise licensee to another, or to a licensed manufacturer. Where bulk spirits are transferred between excise licensees, the transfer must be for further processing or packaging, not simply resale of the bulk spirits as received.

Where a province acquires ownership of bulk spirits for commercial purposes (i.e. if a province produces or packages spirits, or if it has ownership of spirits that are produced or packaged on its behalf), it will fall within the definition of a distiller and will be required to be licensed as an excise licensee.

Possession of Bulk Spirits

Under the proposed excise system, bulk spirits may be possessed only by an excise licensee, a licensed manufacturer, a province or an excise registrant. Persons in possession of bulk spirits will be required to have evidence that the spirits are owned by an excise licensee, a licensed manufacturer, a province or, in the case of imported goods, an unlicensed non-resident. Where imported spirits are owned by an unlicensed non-resident, the person in possession must also be able to identify the excise licensee or the licensed manufacturer who imported the spirits and is liable for the customs duty equivalent.

Disposition of Bulk Spirits

Bulk spirits that are produced by an excise licensee may only be exported; sold to another excise licensee, a licensed manufacturer or a province; taken for use; denatured; or packaged.

Bulk spirits may not be resold (including exported) in an unaltered condition. Where an excise licensee imports bulk spirits or acquires ownership of bulk spirits from another excise licensee, the spirits must be redistilled, blended, denatured, or packaged. The only exception to this rule will be for bulk spirits that are returned in an unaltered condition to the excise licensee who originally sold the spirits.

The owner of bulk spirits will be liable for unaccountable losses of spirits that the owner produced, purchased or imported. The owner will not be liable for duty on the theft of bulk spirits.

Importation of Bulk Spirits

Bulk spirits may only be imported by an excise licensee, a licensed manufacturer, or a province. Imported bulk spirits acquired by an excise licensee must be redistilled, blended, denatured or packaged.

Where imported bulk spirits are owned by an unlicensed non-resident, the importer will be liable for duties in place of the owner. In all other cases, imported bulk spirits must be owned by the importer at the time of importation.

C.2. Packaged Spirits

Packaged spirits will be defined as spirits that have been bottled or otherwise packaged for consumption (this will include spirits packaged for non-beverage purposes).

The excise duty or the customs duty equivalent on packaged spirits will be payable at the time of packaging or importation, unless the packaged spirits are placed in an excise warehouse immediately after being packaged or

imported. Subject to the exceptions outlined below, duty is payable when the packaged spirits are removed from an excise warehouse.

Packaged spirits may be removed from an excise warehouse without payment of duty if they are delivered to another excise warehouse. Packaged spirits may also be removed from an excise warehouse without payment of duty if they are sold and delivered to a licensed manufacturer, registered user, duty-free shop, accredited representative or for use as ships' stores. Finally, packaged spirits may be removed without payment of duty if they are exported from an excise warehouse of the excise licensee who packaged the spirits.

Packaged spirits that are returned unopened to the excise warehouse that sold the product may re-enter the duty-deferred inventory of the warehouse. If excise duty was paid on the returned packaged spirits, a credit may be claimed by the excise warehouse licensee.

Excise warehouse licensees will be liable for duty and penalties on any unaccountable losses of packaged spirits entered into an excise warehouse. The excise warehouse licensee will also be liable for duty on packaged spirits that are stolen.

D. Exports

Bulk spirits may only be exported by the excise licensee who owns the spirits and must be shipped from the premises of the licensee who produced or processed the spirits. Where bulk spirits are sold or delivered to another excise licensee, the spirits must be blended or further processed before being exported in bulk form.

Packaged spirits may only be exported from an excise warehouse of the excise licensee who packaged the spirits, and the excise licensee who packaged the spirits must be the exporter.

Neither bulk spirits nor packaged spirits may enter a customs bonded warehouse prior to export.

E. Duty-Free Sales

Domestic and imported packaged spirits may be supplied by an excise warehouse licensee without payment of duty to duty-free shops, as ships' stores or to accredited representatives. Packaged spirits may also be imported directly by accredited representatives on a duty-free basis.

Under the proposed system, packaged spirits destined for the duty-free market may no longer enter a customs bonded warehouse. Packaged spirits that are supplied to the duty-free market may not enter the domestic duty-paid market.

F. Penalties

Penalty and control provisions under the new excise system will focus on unauthorized ownership, possession and disposition of bulk spirits. For packaged spirits, penalties and controls will relate to the storage, disposition and possession of non-duty-paid spirits.

Penalties will be imposed on excise licensees, excise registrants and excise warehouse licensees for offences relating to the requirement to keep books and records on the operations of their businesses with respect to the production, processing, packaging, storage, transportation or sale of spirits.

Penalties will also be imposed on persons involved in diversion activities or who have unlawful ownership or possession of spirits. Penalties will include seizure and forfeiture of the spirits, the equipment and facilities related to their production and storage, and the vehicles used to transport the spirits.

G. Transition

Under the proposed new excise system, imported spirits may no longer enter or be stored in a customs bonded warehouse. On the date of implementation of the new *Excise Act*, the customs duty equivalent, regular customs duty and GST on imported packaged spirits held in a customs bonded warehouse will become payable under normal customs rules and procedures. Payment of the customs duty equivalent may be deferred if, on the implementation date of the new excise system, imported packaged spirits are placed in an excise warehouse. Payment of the customs duty equivalent will then follow the rules of the new *Excise Act*.

Similarly, for imported bulk spirits that are stored in a customs bonded warehouse, the regular customs duty and GST will become payable according to normal customs rules on the implementation date of the new *Excise Act*. The customs duty equivalent, however, will not be payable until the bulk spirits are packaged or taken for a taxable use.

Annex II

Excise Duty on Beer

Introduction

The proposal for a revised excise framework will impose a production levy on beer. The new system, however, will be significantly different in design and application from the current system, which relies on pervasive controls over the premises and equipment used to produce beer.

The focus of the proposed tax structure will be the control of ownership and possession of bulk beer, combined with a modern administrative system and an audit approach based on self-assessment and after-the-fact verification of books and records.

A. Licensees and Registrants

A.1. Excise Licensee

Under the proposed excise system, a brewer is defined as any person who ferments or packages beer or who owns beer at the time of fermentation or packaging. Any person carrying on the activities of a brewer in Canada will be required to obtain an excise licence and will be referred to as an excise licensee.

A non-resident who owns beer at the time it is produced in Canada is a brewer and will be required to be licensed and post a guarantee bond. A non-resident owner who ships bulk beer into Canada to an excise licensee for blending and packaging is not required to obtain an excise licence, but may apply to be licensed, subject to posting a guarantee bond.

There will be an exception to the licensing requirement for individuals who own beer that was made by the individual, solely for the personal use of the individual and not for commercial use. The exemption for personal use applies only to individuals – clubs and other organizations that make beer

for the personal use of their members will fall within the definition of a brewer and will be required to be licensed and pay excise duty on the quantity of beer packaged.

Excise licensees will be required to maintain books and records related to the production, processing, packaging and sale of beer. An excise licensee must also maintain records related to bulk beer that is owned by the excise licensee but is possessed by another excise licensee or an excise registrant.

A.2. Excise Registrant

An excise registrant is a person who is not an excise licensee but is registered with Revenue Canada to possess or transport bulk beer that is owned by an excise licensee; a licensed manufacturer; a province; an individual (where the beer was made by the individual for the individual's personal use and not for commercial use, and the beer is possessed by an excise registrant at the premises where it was made); or, in the case of imported bulk beer, an unlicensed non-resident.

The excise registrant does not assume liability for excise duty in respect of the bulk beer – the owner or importer remains accountable for bulk beer that is possessed by an excise registrant.

Although excise registrants will not be required to provide notification for every movement of bulk beer, they will be required to maintain books and records that will enable Revenue Canada to verify movements of bulk beer. Registrants will also be required to maintain information on the ownership of bulk beer in their possession. In the case of imported bulk beer owned by an unlicensed non-resident, excise registrants must maintain information identifying the excise licensee or licensed manufacturer who imported the bulk beer.

A.3. Excise Warehouse Licensee

An excise warehouse licensee is a person who is authorized to acquire and store packaged beer on a duty-deferred basis in

premises specified under its licence as an excise warehouse. Only beer that is for export or sale to a licensed manufacturer or to the duty-free market (i.e. duty-free shops, ships' stores or accredited representatives) may be placed in an excise warehouse.

Three classes of persons may apply for an excise warehouse licence – excise licensees, provinces and persons who are not retailers. In general, any premises (except retail premises) used to supply packaged beer for export, the duty-free market, to licensed manufacturers or to other excise warehouse licensees, will be eligible to be an excise warehouse.

A.4. Licensed Manufacturer

A licensed manufacturer is a person licensed under the *Excise Act* to own and possess duty-free bulk beer or non-duty-paid packaged beer for further manufacturing or processing of products in formulations approved by Revenue Canada, or for use in a manufacturing process in which it is completely destroyed.

Discussion of the treatment of beer for non-beverage use by licensed manufacturers is found in the annex “Industrial or Non-Beverage Use of Spirits, Wine or Beer”.

B. Basic Operation

B.1. Domestic Beer

Under the proposal for a revised excise framework, excise duty will be **imposed** and **payable** on the quantity of domestic beer bottled or otherwise packaged for consumption.

Excise duty will be imposed on beer and become payable by the brewer who owns the beer at the time it is packaged. Where bulk beer is taken for a taxable use by an excise licensee or licensed manufacturer without being packaged, excise duty will be **imposed** and become **payable** at the time the bulk beer is taken for use.

The excise duty will be **remittable** by the last day of the month following the month in which it became payable.

B.2. Imported Beer

Imported bulk beer will not be subject to either excise duty or customs duty equivalent. Like domestic beer, excise duty will be imposed and payable by the owner or importer of the beer at the time the imported bulk beer is packaged or taken for a taxable use in Canada.

Excise duty will not apply to imported packaged beer. Instead, a customs duty equivalent to the excise duty will continue to be **imposed** under the *Customs Tariff* at the time of importation. The customs duty equivalent will be **payable** at the time of importation and **remittable** according to customs rules and procedures.

Under the proposed excise system, imported bulk and packaged beer will no longer be allowed to enter a customs bonded warehouse – regular customs duty and GST will be payable at the time of importation under normal customs rules and procedures.

B.3. Domestic and Imported Beer for Duty-Free Sale

Where domestic packaged beer is intended for export or sale to licensed manufacturers or to the duty-free market (i.e. duty-free shops, ships' stores or accredited representatives), payment of the excise duty may be deferred if the beer is placed in an excise warehouse immediately after being packaged. The customs duty equivalent on imported packaged beer destined for export or the duty-free market may be deferred if an excise warehouse licensee is the importer and the beer is delivered by a customs bonded carrier directly to an excise warehouse. Non-duty-paid beer placed in an excise warehouse will not be permitted to enter the domestic duty-paid market.

Where packaged beer is placed in an excise warehouse, liability for payment will transfer from the owner or importer

of the beer to the excise warehouse licensee who has possession of the packaged beer. For imported packaged beer placed in an excise warehouse, liability for payment of the customs duty equivalent will rest with the excise warehouse licensee who imported the beer. Liability for payment of the excise duty or customs duty equivalent will transfer with possession of the packaged beer from one excise warehouse licensee to another, or to a licensed manufacturer.

C. Treatment of Bulk and Packaged Beer

C.1. Bulk Beer

Bulk beer will always be duty free. A key feature of the proposed new system will be the rules governing the ownership, possession, disposition and importation of bulk beer.

Ownership of Bulk Beer

Bulk beer may only be owned by an excise licensee; a licensed manufacturer; a province; an individual (where the beer was made by the individual for the individual's personal use); or, in the case of imported bulk beer, by an unlicensed non-resident owner. Ownership of bulk beer may be transferred from one excise licensee to another, or to a licensed manufacturer.

Where a province acquires ownership of bulk beer for commercial purposes (i.e. if a province produces or packages beer, or if it has ownership of beer that is produced or packaged on its behalf), it will fall within the definition of a brewer and therefore be required to be licensed as an excise licensee.

Possession of Bulk Beer

Under the proposed excise system, bulk beer may only be possessed by an excise licensee; a licensed manufacturer; an individual who makes beer for his or her personal use at a place of residence; a province; or an excise registrant.

Persons in possession of bulk beer will be required to have evidence that the bulk beer is owned by an excise licensee; a licensed manufacturer; a province; an individual (where the beer was made by the individual for the individual's personal use); or, in the case of imported beer, an unlicensed non-resident. Where imported beer is owned by an unlicensed non-resident, the person in possession must also be able to identify the excise licensee or the licensed manufacturer who imported the beer and is accountable for the bulk beer.

Disposition of Bulk Beer

Bulk beer that is produced by an excise licensee may only be exported; sold to another excise licensee, a licensed manufacturer or a province; taken for use; or packaged.

In general, bulk beer may be sold without further processing only by the excise licensee who produced it. Where an excise licensee acquires ownership of bulk beer from another excise licensee, the beer must be blended or further processed or packaged before being sold or exported. An exception to this rule will be for bulk beer that is resold (i.e. returned) to the excise licensee that sold the beer.

The owner of bulk beer will be liable for unaccountable losses of beer that it produces, purchases or imports. The owner will not be liable for penalties on bulk beer that is stolen.

Importation of Bulk Beer

Bulk beer may only be imported by an excise licensee, a licensed manufacturer or a province.

Where imported bulk beer is owned by an unlicensed non-resident, the importer will be liable for unaccountable losses of the beer in place of the owner. In all other cases, imported bulk beer must be owned by the importer at the time of importation.

Bulk beer brought into a province by an excise licensee will continue to be subject to the blending provisions of the *Importation of Intoxicating Liquors Act (IILA)*.

C.2. Packaged Beer

Packaged beer for the domestic market will never have duty deferred. Only beer that is intended for export or sale to a licensed manufacturer or to the duty-free market may be placed in an excise warehouse on a duty-deferred basis.

Packaged beer may be removed from an excise warehouse without the payment of duty if it is delivered to another excise warehouse. Beer may also be removed from an excise warehouse without the payment of duty if it is sold and delivered to a licensed manufacturer or the duty-free market. As well, packaged beer may be removed without the payment of duty if it is exported from an excise warehouse of the excise licensee who packaged the beer. Duty-free packaged beer that is returned unopened to the excise warehouse that sold and delivered the beer may re-enter the duty-deferred inventory of the warehouse.

Non-duty-paid beer in an excise warehouse that is not saleable may only be destroyed by the excise warehouse licensee that has possession of the packaged beer. Liability for duty will be relieved on the destruction of non-duty-paid packaged beer that is unopened.

Under the proposed excise system, a credit will be provided for duty-paid beer returned to excise licensees for destruction because of product or packaging quality concerns. A credit will be provided for beer that is destroyed, provided it is returned unopened to the premises of the excise licensee who packaged the beer. The credit will be given to the excise licensee who owned the beer at the time of packaging and who was responsible for payment of the duty.

A credit will also continue to be provided for beer that is sampled for quality control purposes. Sampling may occur only on the premises of the excise licensee who packages the beer.

An excise warehouse licensee will be liable for the duty and penalties on any unaccountable losses of packaged beer that it enters into an excise warehouse on a duty-deferred basis. The excise warehouse licensee will also be liable for duty on packaged beer that is stolen.

D. Exports

Bulk beer may only be exported by the excise licensee who owns the beer and must be shipped from the premises of the licensee who produced or processed the beer. Where bulk beer is sold or delivered to another excise licensee, the beer must be blended or further processed before being exported in bulk form.

Packaged beer may only be exported duty free from an excise warehouse of the excise licensee who packaged the beer. The excise licensee who packaged the beer must be the exporter.

Neither packaged beer nor bulk beer can be entered into a customs bonded warehouse prior to export.

E. Duty-Free Sales

Domestic and imported packaged beer may be supplied by an excise warehouse licensee without payment of duty to duty-free shops, as ships' stores or to accredited representatives. Packaged beer may also be imported directly by accredited representatives on a duty-free basis.

Under the new system, packaged beer destined for the duty-free market may no longer enter a customs bonded warehouse. Packaged beer that is supplied to the duty-free market may not enter the domestic duty-paid market.

F. Home Beer-Making and U-Brews

Under the proposed excise structure, individuals who make beer for their personal use and not for commercial use will continue to be exempt from the excise licensing requirements and from the payment of excise duty. The personal use

exemption will be limited to "individuals", not "persons" – this distinction excludes from the exemption all clubs and other organizations that might be legally defined as "persons".

Beer made at a u-brew establishment will be exempt from excise duty if the individual customer ferments and packages the beer. In these circumstances, the steps taken by the individual are comparable to home beer-making and the beer will be considered to have been made by an individual. Even if the intermediate steps such as filtering the beer are performed by the u-brew operator, the beer will be exempt from excise duty.

If, however, the u-brew operator ferments or packages the finished beer, then the u-brew operator will be considered a brewer and will be required to obtain an excise licence and pay excise duty on the quantity of beer packaged.

A key feature of the proposed excise system is the requirement that all persons who possess bulk beer other than excise licensees, licensed manufacturers or individuals who make beer for their personal use at a place of residence, be registered with Revenue Canada. Since in the course of the beer-making process, u-brew operators will have in their possession bulk beer belonging to their customers, u-brew operators will be required to be excise registrants and may only possess bulk beer that is owned by an individual and that was produced at the u-brew operator's premises.

G. Penalties

Penalty and control provisions under the new proposed excise system will focus on unauthorized ownership, possession and disposition of bulk beer. For packaged beer, penalties and controls will relate to the storage, disposition and possession of non-duty-paid beer.

Penalties will be imposed on excise licensees, excise registrants and excise warehouse licensees for offences relating to the requirement to keep books and records on the

operations of their businesses with respect to the production, processing, packaging, storage, transportation or sale of beer.

Penalties will also be imposed on persons involved in diversion activities or who have unlawful ownership or possession of beer. Penalties will include seizure and forfeiture of the beer, the equipment and facilities related to its production and storage, and the vehicles used to transport it.

H. Transition

Under the proposed excise system, imported beer may no longer enter or be stored in a customs bonded warehouse. On the date of implementation of the new *Excise Act*, the customs duty equivalent, regular customs duty and GST on imported packaged beer held in a customs bonded warehouse will become payable under normal customs rules. However, payment of the customs duty equivalent on beer intended for sale to licensed manufacturers or to the duty-free market may be deferred if, on the implementation date of the new excise system, imported packaged beer is placed in an excise warehouse.

For imported bulk beer that is stored in a customs bonded warehouse, the regular customs duty and GST will become payable according to normal customs rules on the implementation date of the new *Excise Act*. Since bulk beer will be duty free under the new excise system, liability for the customs duty equivalent will be removed on imported bulk beer. Instead, excise duty will be imposed and payable when the imported bulk beer is packaged or taken for a taxable use.

Annex III

Excise Duty on Wine

Introduction

The proposal for a revised excise framework will impose a production levy on wine. The new system, however, will be significantly different in design and application from the current system of production levies that apply to spirits and beer, which rely on pervasive controls over the premises and equipment used to produce spirits or beer.

The focus of the proposed tax structure for wine will be the control of ownership and possession of bulk wine, combined with a modern administrative system and an audit approach based on self-assessment and after-the-fact verification of books and records.

A. Licensees and Registrants

A.1. Excise Licensee

Under the proposed excise system, a vintner will be defined as any person who ferments or packages wine, or who owns wine at the time of fermentation or packaging. Any person carrying on the activities of a vintner in Canada will be required to obtain an excise licence and will be referred to as an excise licensee.

A non-resident who owns wine at the time it is produced in Canada is a vintner and will be required to be licensed and post a guarantee bond. A non-resident owner who ships bulk wine into Canada to an excise licensee for packaging is not required to obtain an excise licence, but may apply to be licensed, subject to posting a guarantee bond.

There will no longer be an exception to the licensing requirement for small manufacturers – all vintners will be required to obtain an excise licence even where the value of the wine that they manufacture and sell does not exceed

\$50,000 in a calendar year. There will continue to be an exception to the licensing requirement for individuals who own wine that was made by the individual solely for the personal use of the individual and not for commercial use. The exemption for personal use applies only to individuals – clubs and other organizations that make wine for the personal use of their members will fall within the definition of a vintner and will be required to be licensed and pay excise duty on the quantity of wine packaged.

Excise licensees will be required to maintain books and records related to the production, processing, packaging and sale of wine. An excise licensee must also maintain records related to bulk wine that is owned by the licensee but is possessed by another excise licensee or an excise registrant.

A.2. Excise Registrant

An excise registrant is a person who is not an excise licensee but who may possess or transport bulk wine that is owned by an excise licensee; a province; a licensed manufacturer; an individual (where the wine was made by the individual for the individual's personal use and not for commercial use, and the wine is possessed by an excise registrant at the premises where it was made); or, in the case of imported bulk wine, an unlicensed non-resident.

The excise registrant does not assume liability for excise duty in respect of the bulk wine – the owner or importer remains accountable for bulk wine that is possessed by an excise registrant.

Excise registrants will not be required to provide notification for every movement of bulk wine but they will be required to maintain books and records to enable Revenue Canada to verify movements of bulk. Excise registrants will also be required to maintain in their possession information on the ownership of bulk wine that they possess. In the case of imported bulk wine owned by an unlicensed non-resident, excise registrants must maintain information identifying the

excise licensee or licensed manufacturer who imported the bulk wine.

A.3. Excise Warehouse Licensee

An excise warehouse licensee is a person who is authorized to acquire and store packaged wine on a duty-deferred basis in premises specified under its licence as an excise warehouse.

Three classes of persons may apply for an excise warehouse licence – excise licensees, provinces and persons who are not retailers. In general, any premises (except retail premises) used to supply packaged wine to two or more retail stores or other excise warehouse licensees will be eligible to be an excise warehouse.

An excise warehouse licence will also be issued to a person in respect of a warehouse used to supply wine to the export or duty-free markets, or to licensed manufacturers.

A.4. Licensed Manufacturer

A licensed manufacturer is a person licensed under the *Excise Act* to own and possess duty-free bulk wine or non-duty-paid packaged wine for further manufacturing or processing of products in formulations approved by Revenue Canada, or for use in a manufacturing process in which it is completely destroyed.

Discussion of the treatment of wine for non-beverage use by licensed manufacturers is found in the annex entitled, “Industrial or Non-Beverage Use of Spirits, Wine or Beer”.

B. Basic Operation

B.1. Domestic Wine

Under the proposal for a revised excise framework, excise duty will be **imposed** and **payable** on the quantity of domestic wine bottled or otherwise packaged for consumption.

Excise duty will be imposed on wine and become payable by the vintner who owns the wine at the time it is packaged. Where bulk wine is taken for a taxable use by an excise licensee or licensed manufacturer without being packaged, excise duty will be **imposed** and become **payable** at the time the bulk wine is taken for use.

The payment of excise duty may be **deferred** if, immediately after packaging, the wine is placed in an excise warehouse. Liability for payment of excise duty will transfer from the owner of the wine to the excise warehouse licensee who has possession of the packaged wine. Excise duty will be **payable** when the wine is removed from the excise warehouse unless it is exported, sold to a licensed manufacturer or the duty-free market, or transferred to another excise warehouse.

The excise duty will be **remittable** by the last day of the month following the month in which it became payable.

B.2. Imported Wine

Imported bulk wine will not be subject to either excise duty or customs duty equivalent. Like domestic wine, excise duty will be imposed and become payable by the owner or importer of the wine at the time the imported bulk wine is packaged or taken for a taxable use in Canada.

Imported packaged wine will be subject to a customs duty equivalent to the excise duty on domestic wine. The customs duty equivalent will be payable at the time of importation according to customs rules, unless the importer is an excise warehouse licensee and the packaged wine is delivered by a customs bonded carrier directly to an excise warehouse. For imported packaged wine that enters an excise warehouse, customs duty equivalent will be administered in the same manner as the excise duty on domestic product (i.e. the duty will be payable when the packaged wine is removed from an excise warehouse).

Imported bulk and packaged wine may not enter a customs bonded warehouse. The regular customs duty and GST will be payable at the time of importation under normal customs rules and procedures.

C. Treatment of Bulk and Packaged Wine

C.1. Bulk Wine

Bulk wine will always be duty free. A key feature of the proposed new system will be the rules regarding the ownership, possession, disposition and importation of bulk wine.

Ownership of Bulk Wine

Bulk wine may only be owned by an excise licensee, a province, a licensed manufacturer, an individual (where the wine was made by the individual for the individual's personal use) and, in the case of imported bulk wine, an unlicensed non-resident. Ownership of bulk wine may be transferred from one excise licensee to another, or to a licensed manufacturer.

Where a province acquires ownership of bulk wine for commercial purposes (i.e. if a province produces or packages wine, or if it owns wine that is produced or packaged on its behalf), it will fall within the definition of a vintner and therefore be required to be licensed as an excise licensee.

Possession of Bulk Wine

Under the proposed excise system, bulk wine may only be possessed by an excise licensee, a licensed manufacturer, a province, an individual who makes wine for his or her personal use at a place of residence, or an excise registrant. Persons in possession of bulk wine will be required to have evidence that the wine is owned by an excise licensee, a licensed manufacturer, a province, an individual (where the wine was made by the individual for the individual's personal use) or, in the case of imported bulk wine, an unlicensed

non-resident. Where imported wine is owned by an unlicensed non-resident, the person in possession must also be able to identify the excise licensee or the licensed manufacturer who imported the wine and is accountable for the bulk wine.

Disposition of Bulk Wine

Bulk wine that is produced by an excise licensee may only be exported, sold to another excise licensee or a licensed manufacturer, sold to a province, taken for use or packaged.

In general, bulk wine may be sold without further processing only by the excise licensee who produced the wine. Where an excise licensee imports bulk wine or acquires ownership of bulk wine from another excise licensee, the wine must be blended, processed or packaged before being sold or exported. The only exception to this rule will be for bulk wine that is resold (i.e. returned) to the excise licensee that sold the wine.

The owner of bulk wine will be liable for unaccountable losses of wine that it produces, purchases or imports. The owner will not be liable for penalties on bulk wine that is stolen.

Importation of Bulk Wine

Bulk wine may only be imported by an excise licensee, a province or a licensed manufacturer. Imported bulk wine acquired by an excise licensee must be blended, processed or packaged before being resold.

Where imported bulk wine is owned by an unlicensed non-resident, the importer will be liable for unaccountable losses of the wine in place of the owner. In all other cases, imported bulk wine must be owned by the importer at the time of importation.

C.2. Packaged Wine

Packaged wine is wine that has been bottled or otherwise packaged for consumption. The excise duty or customs duty

equivalent on packaged wine will be imposed and payable at the time of packaging or importation unless the wine is placed in an excise warehouse immediately after packaging or importation, in which case payment of the excise duty or the customs duty equivalent will be deferred.

Under the proposed new structure, packaged wine may be removed from an excise warehouse without payment of duty if the wine is for delivery to another excise warehouse. Packaged wine may also be removed from an excise warehouse without payment of duty if it is sold and delivered to a licensed manufacturer, duty-free shops, accredited representatives or for use as ships' stores. As well, packaged wine may be removed from an excise warehouse without payment of duty if it is exported from an excise warehouse of the excise licensee who packaged the wine.

Packaged wine that is returned unopened to the excise warehouse that sold the wine may re-enter the duty-deferred inventory of the warehouse. If excise duty was paid on the returned packaged wine, a credit may be claimed by the excise warehouse licensee.

Excise warehouse licensees will be liable for the duty and penalties on any unaccountable losses of packaged wine entered into an excise warehouse. The excise warehouse licensee will also be liable for duty on packaged wine that is stolen.

D. Exports

Bulk wine may only be exported by the excise licensee who owns the wine and must be shipped from the premises of the licensee who produced or processed the wine. Where bulk wine is sold or delivered to another excise licensee, the wine must be blended or further processed before being exported in bulk form.

Packaged wine may only be exported duty free from an excise warehouse of the excise licensee who packaged the wine. The excise licensee who packaged the wine must be the exporter.

Neither packaged wine nor bulk wine can be entered into a customs bonded warehouse prior to export.

E. Duty-Free Sales

Domestic and imported packaged wine may be supplied by an excise warehouse licensee without payment of duty to duty-free shops, as ships' stores or to accredited representatives. Packaged wine may also be imported directly by accredited representatives on a duty-free basis.

Under the proposed new excise system, packaged wine destined for the duty-free market may not enter a customs bonded warehouse. Packaged wine that is supplied to the duty-free market may not enter the domestic duty-paid market.

F. Home Wine-Making and U-Vins

Individuals who make wine will be exempt from the excise license requirements and from the payment of excise duty as long as the wine is made by the individual for his or her personal use and not for commercial use. The personal use exemption will be limited to "individuals", not "persons". As a result, clubs and other organizations that might be legally defined as "persons", will not qualify for the personal use exemption.

Wine made at a u-vin establishment will be exempt from excise duty only when the individual customer ferments and packages the wine. In these circumstances, the steps taken by the individual are comparable to home wine-making and the wine will be considered to have been made by an individual. Even if the intermediate steps such as filtering and racking the wine are performed by the u-vin operator, the wine will be exempt from excise duty.

If, however, the u-vin operator ferments or packages the finished wine, then the u-vin operator will be considered a vintner and will be required to obtain an excise licence and pay excise duty on the quantity of wine packaged.

A key feature of the proposed framework is to require all persons who possess bulk wine other than excise licensees, licensed manufacturers or individuals who make wine for their personal use at a place of residence, to be excise registrants. Since in the course of the wine-making process u-vin operators will have in their possession bulk wine belonging to their customers, u-vin operators will be required to be excise registrants. U-vin operators will be permitted to possess bulk wine, which is owned by an individual, at the u-vin premises where the wine was produced.

G. Penalties

Penalty and control provisions under the excise system will focus on unauthorized ownership, possession and disposition of bulk wine. For packaged wine, penalties and controls will relate to the storage, disposition and possession of non-duty-paid wine.

Penalties will be imposed on excise licensees, excise registrants and excise warehouse licensees for offences relating to the requirement to keep books and records on the operations of their businesses with respect to the production, processing, packaging, storage, transportation or sale of wine.

Penalties will be imposed on persons involved in diversion activities or who have unlawful ownership or possession of wine. Penalties will include seizure and forfeiture of the wine, the equipment and facilities related to its production and storage, and the vehicles used to transport it.

H. Transition

Under the proposed new excise structure, a rebate of excise tax will be available for excise tax paid on domestic packaged wine that is stored by a person who is an excise warehouse licensee on the date of implementation of the new *Excise Act*.

Under the proposed new excise structure, imported wine may no longer enter or be stored in a customs bonded warehouse. On the date of implementation of the new *Excise Act*, the

excise tax, regular customs duty and GST on imported packaged wine held in a customs bonded warehouse will become payable under normal customs rules and procedures. Payment of the excise tax may be deferred if, on the implementation date, the imported packaged wine is placed in an excise warehouse. Payment will then follow the rules of the new *Excise Act*.

For imported bulk wine that is stored in a customs bonded warehouse, the regular customs duty and GST will become payable according to normal customs rules on the implementation date of the new *Excise Act*. The new excise duty will not be imposed until the bulk wine is packaged or taken for a taxable use.

Wine that has been packaged at a Canadian winery but has not yet been delivered to a purchaser will be subject to excise duty on the implementation date. However, payment of the excise duty may be deferred if, on the implementation date, the packaged wine is placed in an excise warehouse. Payment of the excise duty will then follow the rules of the new *Excise Act*.

For those wineries that are now defined as small manufacturers by the *Excise Tax Act*, excise duty will not be imposed on existing inventories of packaged wine. Excise duty will be imposed on wine which is packaged on and after the implementation date according to the rules of the new *Excise Act*. Bulk wine owned by a winery that is now defined as a small manufacturer by the *Excise Tax Act* will be subject to excise duty, which will be imposed when the bulk wine is packaged or taken for a taxable use according to the rules of the new *Excise Act*.

Annex IV

Industrial or Non-Beverage Use of Spirits, Wine or Beer

Introduction

The proposed excise structure for industrial or non-beverage alcohol¹ will be similar in many respects to the existing structure, although key changes have been proposed to address areas of complexity and inequity. A significant change is the elimination of the variable rates of duty that currently apply to spirits for specified uses. All authorized non-beverage uses of spirits will now be duty free. Duty-free applications will also be extended to certain uses of wine and beer.

The regulation of duty-free alcohol for non-beverage purposes will continue to rely on approval of product formulas; specification of uses and denaturing standards; and the licensing, registration or authorization of users. These controls, which serve primarily to protect beverage alcohol excise revenues, are based on and integrated with the basic concepts governing the production and warehousing of alcohol, which are explained in greater detail in the annexes covering spirits, wine and beer.

A. Licensees, Registrants or Permit Holders

Under the proposed new excise structure, requirements with respect to licensing, registration or authorization will continue to depend on the form of spirits to be used for non-beverage purposes. Spirits will continue to be defined in three general forms:

- Undenatured spirits – unaltered spirits in a potable form;

¹ For purposes of this annex, the term “alcohol” will refer to spirits, wine or beer and “spirits” to undenatured spirits.

- Specially denatured spirits – spirits mixed with special denaturants approved by Revenue Canada that may render the product non-potable and make recovery of the spirits less economical; and
- Denatured spirits – spirits mixed with special denaturants approved by Revenue Canada that render the product non-potable and make recovery of the spirits not economical.

Non-beverage use of beer or wine will be treated in the same manner as undenatured spirits.

A.1. Licensed Manufacturer

A “licensed manufacturer” is a person licensed under the *Excise Act* to own and possess non-duty-paid bulk or packaged alcohol for further manufacturing or processing of products in formulations approved by Revenue Canada or for use in a manufacturing process in which the ethyl alcohol is completely destroyed.

The category of “licensed manufacturer” will be similar to, and will replace, the category of “bonded manufacturer” under the existing *Excise Act*. As under the existing excise system, Revenue Canada’s approval will be required for each formulation using alcohol.

Licensed manufacturers wishing to use undenatured spirits will be required to demonstrate or provide evidence, at the time of application for formula approval, that no grade of denatured or specially denatured spirits is suitable for the product to be produced.

Formula approval will not be required for the fortification of domestic wine or the production of vinegar. For vinegar, minimum standards of production will be established based on the use of either spirits, beer or wine.

Licensed manufacturers will be required to maintain books and records related to the acquisition, use and disposition of

alcohol. A licensed manufacturer must also maintain records related to bulk alcohol that is owned by the manufacturer but is possessed by an excise licensee or an excise registrant.

A.2. Registered User

A “registered user” is a person who, having met specified qualifications in the *Excise Act*, is authorized by Revenue Canada to use spirits for particular purposes duty free. The qualifications and uses of spirits will be:

- any scientific and research laboratory in receipt annually of aid from the government of Canada or a province may use spirits duty free, for scientific purposes only;
- any bona fide public hospital or municipal health clinic certified by Revenue Canada may use spirits duty free, for medicinal purposes or use as a disinfectant; or
- any university or other post-secondary educational institution recognized by a province may use spirits duty free, for scientific purposes only.

Revenue Canada may approve and register the users who meet these qualifications.

Registered users will be required to maintain books and records related to the acquisition, use and disposition of duty-free packaged spirits.

A.3. SDS Permit Holder

An “SDS permit holder” is a person authorized by Revenue Canada to own and possess a particular grade of specially denatured spirits for a specified non-beverage use.

Under the proposed excise structure, the treatment of specially denatured spirits will be similar in many respects to the treatment under the existing *Excise Act*. One notable exception is for public hospitals which, under the proposed structure, will now be required to be SDS permit holders to acquire most grades of specially denatured spirits. Public

hospitals may continue to acquire rubbing alcohol, a particular grade of specially denatured spirits, without a permit.

Under the proposed excise structure, SDS permit holders will be required to maintain records related to the acquisition, use and disposition of specially denatured spirits. Certain exceptions to the record-keeping requirement will be made for rubbing alcohol.

A.4. Excise Licensee

The proposed new excise structure governing the production of alcohol will apply to producers, packagers and owners of alcohol intended for industrial or non-beverage uses. A person who is a distiller, brewer or vintner will be required to be licensed as an “excise licensee”.

A.5. Excise Warehouse Licensee

An “excise warehouse licensee” is a person who is authorized to acquire and store packaged alcohol on a duty-deferred basis in premises specified under its licence as an excise warehouse. Duty deferral on packaged beer will be restricted to beer for the duty-free market or sale to licensed manufacturers. Three classes of persons may apply for an excise warehouse licence: excise licensees, provinces and persons who are not retailers.

A.6. Excise Registrant

An “excise registrant” is a person who is not an excise licensee but is registered with Revenue Canada to possess or transport bulk alcohol that is owned by an excise licensee; a licensed manufacturer; a province; or, in the case of imported bulk alcohol, an unlicensed non-resident.

An excise registrant is also a person who is not an excise licensee but is registered with Revenue Canada to possess or transport bulk or packaged specially denatured spirits that are owned by: an excise licensee; an SDS permit holder; or, in the

case of imported specially denatured spirits, an unlicensed non-resident.

Although excise registrants will not be required to provide notification for every movement of bulk alcohol and specially denatured spirits, they will be required to maintain adequate books and records to enable Revenue Canada to verify movement of product. Registrants will also be required to maintain information on the ownership of bulk alcohol and specially denatured spirits in their possession.

In the case of imported bulk alcohol and specially denatured spirits owned by an unlicensed non-resident, excise registrants must maintain information identifying the excise licensee or licensed manufacturer who imported the bulk alcohol and the SDS permit holder who imported the specially denatured spirits.

B. Non-Beverage Use of Spirits, Wine or Beer

B.1. Licensed Manufacturer

Under the proposed excise structure, licensed manufacturers will be able to acquire bulk alcohol from excise licensees and packaged alcohol from excise warehouse licensees on a non-duty-paid basis. As well, licensed manufacturers may directly import bulk alcohol and packaged alcohol on a duty-deferred basis.

Licensed manufacturers will be liable for excise duty or customs duty equivalent on bulk spirits and packaged beer, wine and spirits that they acquire. Although excise duty will not be imposed on bulk beer or wine until it is packaged or taken for a taxable use, licensed manufacturers will be accountable for any losses of these bulk products.

Where bulk or packaged alcohol is used in formulations or processes approved by Revenue Canada, no duty will be payable. However, excise duty or customs duty equivalent will be payable by licensed manufacturers where alcohol is taken for an unauthorized use, at the time it is taken for use.

A special excise duty of \$0.12 per litre of absolute alcohol will continue to apply to imported spirits acquired by a licensed manufacturer. This excise duty will be imposed and payable on bulk or packaged spirits at the time of importation by the licensed manufacturer. Where imported spirits are acquired from an excise licensee or an excise warehouse licensee, the special excise duty will be payable at the time of sale to a licensed manufacturer, and will be remittable by the excise licensee or excise warehouse licensee.

Bulk alcohol acquired by a licensed manufacturer may not be resold except where it is returned to the excise licensee who sold the alcohol. Packaged alcohol may be returned unopened in its original container to the excise warehouse that supplied the packaged alcohol. The sale of alcohol by a licensed manufacturer in any other circumstance will not be permitted.

Licensed manufacturers will be liable for duties and penalties on unaccountable losses of bulk and packaged alcohol. Licensed manufacturers will also be liable for duty on packaged alcohol that is stolen. Duties or penalties will not apply to theft of bulk alcohol.

B.2. Registered User

Registered users will be able to acquire packaged spirits duty free for specified purposes, but not beer or wine. Packaged spirits may be sold and delivered from an excise warehouse to a registered user duty free.

Packaged spirits acquired by a registered user may not be resold except where they are returned unopened in their original container to the excise warehouse that supplied the product. The sale of spirits by a registered user in any other circumstance will not be permitted.

Registered users will be liable for penalties for any unaccountable losses, unauthorized use or sale of duty-free packaged spirits. Registered users will also be liable for penalties on spirits that are stolen.

C. Non-Beverage Use of Specially Denatured Spirits

Under the proposed excise structure, excise duty will continue to be relieved on spirits that are denatured by an excise licensee to a “specially denatured spirits grade” (SDSG) approved by Revenue Canada. Similarly, the customs duty equivalent imposed on imported spirits will not apply if the product is an approved SDSG.

Only an SDS permit holder may purchase or import specially denatured spirits, and only those grades that are specified under the permit. An exception will continue to be made for rubbing alcohol, which may be sold by an excise licensee to, or imported by, an institution certified by Revenue Canada as a public hospital.

Specially denatured spirits acquired by an SDS permit holder may not generally be resold – they must be either used by the permit holder for the authorized use or returned to the excise licensee who sold the specially denatured spirits. An exception will be made for rubbing alcohol, which may be resold to another SDS permit holder with authorization for this grade; to any institution certified as a public hospital; or to any person for resale to the public, if the rubbing alcohol is packaged.

Although liability for duty is removed on spirits denatured to an approved grade of specially denatured spirits, the owner or importer will be subject to penalties for any unaccountable losses or unauthorized use or sale of specially denatured spirits. The owner or importer will also be liable for penalties on packaged specially denatured spirits that are stolen. Penalties will not apply to the theft of bulk specially denatured spirits.

D. Non-Beverage Use of Denatured Spirits

Under the proposed excise structure, excise duty will continue to be relieved on spirits that are denatured by an excise licensee to a “denatured spirits grade” (DSG) approved by

Revenue Canada. Similarly, the customs duty equivalent imposed on imported spirits will not apply if the product is an approved DSG.

Spirits that have been denatured to a DSG approved by Revenue Canada will not be subject to further controls or restrictions on their sale or use, other than a prohibition of any attempt to deodorize or clarify these spirits.

E. Penalties

Under the proposed new excise system, penalty and control provisions for industrial or non-beverage uses of alcohol will relate to the diversion of non-duty-paid or duty-free alcohol and specially denatured spirits from the approved end uses. These will be supplemented by general penalty and control provisions that focus on the unauthorized ownership, possession and disposition of bulk alcohol and, for packaged alcohol, on the storage, possession and disposition of non-duty-paid alcohol.

Penalties will be imposed on licensed and authorized non-beverage users for offences relating to the requirements to keep books and records on the operations of their businesses with respect to the acquisition, storage, disposition and use of non-duty-paid alcohol. Penalties related to the keeping of books and records will also apply to specially denatured spirits.

Penalties will also be imposed on persons involved in diversion activities or who have unlawful possession of alcohol or specially denatured spirits. Penalties will include seizure and forfeiture of the alcohol, the equipment and facilities related to its production and storage, and the vehicles used to transport it.

Annex V

The Design of the Excise Duty on Tobacco

Introduction

Current System

Tobacco products are currently subject to both excise duty imposed as a production levy and excise tax imposed as a sales levy.

Excise duties are imposed under the *Excise Act* on domestic cigarettes, cigars, tobacco sticks, other forms of manufactured tobacco (fine cut) and Canadian raw leaf tobacco at the time these products are packaged for consumption. A customs duty equivalent to the excise duty is imposed under the *Customs Tariff* on imports of these products.

Excise taxes are currently imposed under the *Excise Tax Act* on domestic and imported cigarettes, cigars, tobacco sticks and other forms of manufactured tobacco (fine cut) at the time the manufacturer delivers these products to a purchaser or at the time of importation. An excise tax is also imposed on exports of tobacco.

Prior to 1994, federal excise duty and excise tax rates were the same in every province. With the announcement of the National Action Plan on Smuggling in February 1994, however, the federal government reduced excise tax rates on most tobacco products by a base amount across the country and by various additional amounts in Ontario, Quebec, New Brunswick, Nova Scotia and Prince Edward Island to match provincial tobacco tax reductions. While there have been modest federal excise tax increases in some of these provinces over the interim, federal excise tax rates on tobacco products continue to vary from one province to another.

Proposed System

The fundamental structure of the excise duty on tobacco will remain substantially the same under the revised excise framework. Excise duty will continue to be **imposed** and **payable** by the manufacturer at the time domestic tobacco is packaged for consumption. Duty will also continue to be **imposed** and **payable** on imported tobacco by the importer at the time of importation, although the system will be simplified by imposing the duty directly under the *Excise Act* rather than as a customs duty equivalent under the *Customs Tariff*.

While the fundamental structure will remain substantially the same, a number of changes are being proposed that will simplify, streamline and update the excise duty system. The key change will be that the excise taxes currently applied under the *Excise Tax Act* will be rolled into the excise duty structure. The rate of excise duty on cigarettes, tobacco sticks and manufactured tobacco will vary from one province to another to reflect the differences in current excise tax rates, but the overall tax burden will not be increased as a result of this proposed change. The export tax on tobacco products will be maintained.

The new system also proposes that the time for **remittance** of excise duty on domestic tobacco be extended from the end of the month the tobacco is packaged for consumption, to the end of the month following the month the tobacco is packaged for consumption. The duty on imported tobacco will be **remittable** under customs rules. This change represents an important step toward the implementation of Revenue Canada's integrated accounting system.

In addition, the duty-deferral system for tobacco intended for duty-free sale or export, which currently involves both excise bonding and customs bonded warehouses, will be consolidated into the single channel of excise warehouses. As a result, under the new system, tobacco will no longer be permitted to enter into customs bonded warehouses.

Finally, pervasive controls on the premises and manufacturing process will be replaced with a system based on self-assessment and after-the-fact verification of books and records. To modernize the administration of excise duties, the requirement to post guarantee bonds will be eliminated and new assessment, appeal and collection systems will be introduced.

A. Basic Operation

A.1. Licensees

Tobacco and cigar manufacturers will be required to be licensed as excise licensees under the new system. Tobacco packers will continue to be licensed as packers.

Excise licensees will be entitled to an exemption for imports of partly manufactured tobacco for the purpose of further processing. The exemption from licensing under the *Excise Tax Act* for small manufacturers whose sales do not exceed \$50,000 in a calendar year will no longer be available.

A.2. Domestic Tobacco

Under the proposed system, excise duty will continue to be imposed on domestic tobacco products at the time they are packaged for consumption. As well, manufacturers will continue to be required to stamp tobacco products at the time of packaging to signify that duty has been paid at the rates applicable in the province where the tobacco is to be sold for consumption.

Exemption from excise duty will be available for domestic tobacco placed in an excise warehouse, so long as it is marked to reflect the fact that it is intended for duty-free sale or export. The excise warehouse licensee who has physical possession of the tobacco will be liable for penalties for diversion to the domestic market.

A.3. Imported Tobacco

Under the current system, imports of tobacco are subject to a customs duty equivalent under the *Customs Tariff* and an excise tax under the *Excise Tax Act* at the time of importation.

To simplify the tax structure, the new system will replace the two existing levies with an excise duty. Excise duty will be imposed on imported tobacco under the *Excise Act* at the time of importation. There will continue to be a requirement that imported tobacco be stamped at the time of importation to signify that excise duty has been paid at the rates applicable in the province where the tobacco is to be sold for consumption.

Exemption from excise duty and regular customs duty will be available for imported tobacco placed in an excise warehouse, so long as it is marked at the time of importation for duty-free sale or export.

The system will be streamlined by consolidating the current excise bonding warehouses and customs bonded warehouses into a single excise warehouse. As a result, imported tobacco will no longer be permitted to enter a customs bonded warehouse. To promote the equal treatment of imported and domestic tobacco, deferral of GST on imported tobacco will not be available under the proposed system.

B. Excise Warehouses

Excise warehouse licences may only be held by excise licensees, provinces or persons who are not retailers. Domestic and imported tobacco products for the duty-free market or for export will continue to be closely regulated under the new consolidated excise warehouse system.

B.1. Domestic Tobacco

Domestic tobacco intended for export or duty-free shops may only be held in the excise warehouse of the excise licensee who packaged the tobacco. Similarly, domestic tobacco

destined for accredited representatives may only be held in the excise warehouse of the excise licensee who packaged the tobacco, or by the excise warehouse licensee authorized by the excise licensee to sell to accredited representatives. Finally, domestic tobacco intended for ships' stores may be held in any excise warehouse that is making duty-free supplies to persons authorized to buy ships' stores.

B.2. Imported Tobacco

Any excise warehouse licensee may import tobacco for sale to duty-free shops, accredited representatives, as ships' stores or for export. In addition, duty-free shops and accredited representatives may import tobacco directly.

B.3. Marking

Domestic tobacco intended for export or the duty-free market must be marked at the time it is placed in an excise warehouse. Packages of tobacco destined for export must be marked "Not for Sale in Canada" while tobacco for duty-free sale in Canada must be marked "Duty Not Paid".

Imported tobacco intended for export or the duty-free market must be marked at the time of importation. Packages destined for export must be marked "Not for Sale in Canada" while tobacco for duty-free sale in Canada must be marked "Duty Not Paid".

When tobacco is imported into Canada in packages that do not meet stamping or marking requirements, it must be put in a customs sufferance warehouse until the packages are properly stamped or marked.

B.4. Diversion

Tobacco that has been placed in an excise warehouse will continue to be prohibited from entering the duty-paid domestic market – it must be exported, sold to duty-free purchasers or destroyed. Where tobacco marked as

non-duty-paid is found in the duty-paid domestic market, it will continue to be treated as a diversion of product.

C. Transition

C.1. Inventory Conversion Under the *Excise Tax Act*

As a result of excise tax being rolled into excise duty, tobacco manufacturers will be in a position where they are holding tax-free inventories of tobacco that will now be required to be duty paid. On the date of implementation, excise tax will become payable and will be required to be remitted at the end of the following fiscal month.

C.2. Customs Bonded Warehouses

On the date of implementation, inventory held in customs bonded warehouses free of regular customs duty and the customs duty equivalent may be converted into inventory held in excise warehouses free of regular customs duty and excise duty.

Deferral of GST will no longer be available under the proposed system. As a result, the GST on tobacco held in customs bonded warehouses on the implementation date will become payable under regular customs rules.

